In the Supreme Court of the United States

OCTOBER TERM, 1972

No. 71-1665

UNITED STATES OF AMERICA, PETITIONER,

v.

DOUGLAS B. CARTWRIGHT, as Executor of the Estate of ETHEL B. BENNETT

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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IN THE

United States District Court

FOR THE WESTERN DISTRICT OF NEW YORK

Civil No. 1968-164

DOUGLAS B. CARTWRIGHT, as Executor of the Estate of ETHEL B. BENNETT,

Plaintiff,

v.

UNITED STATES OF AMERICA,

Defendant.

Docket Entries.

Civ-1968-164 Douglas B. Cartwright, etc. v. US.

Date		*Proceedings*
1968		
May	14	Filed Complaint
May	14	Issued summons & 4 copies
May	14	JS 5 made
May	21	Filed summons—served 5/16/68
July	11	Filed Deft's Answer
July	22	Filed Pltf's. Note of Issue—Nov. 1968 Term
Aug.	21	Filed Pltf's. Note of Issue—Nov. 1969 Term
Nov.	13	Filed Deft's. Answers to Pltf's. Request for Admissions
Dec.	9	Pretrial Conference (JTC).

Date		*Proceedings*
1970		
Feb.	27	Pretrial Conference (JTC).
Apr.	3	Trial before Judge Curtin. Submitted
Oct.	16	Filed Court Reporter's Proceedings of 4/3/70
Dec.	10	Filed Henry S. Fraser's Affidavit & Notice of Motion for leave to appear as *amicus curiae*-ret. 12/17/70.
1971		
Feb.	22	Filed Decision & Order that judgment be entered in favor of Pltf.—Curtin, J. (notice & copy to Messrs. Gregg; Walters, Asst. Atty. Gen. Washington, D. C. & Schroeder).
Feb.	22	Filed Pltf's. Admissions as requested by Pltf., & as revised by Deft., in his answer to the request (illegible).
Apr.	16	Filed Judgment in favor of Pltf. in amount of $2,699.41 with interest at 6% and costs—Curtin, J. (notice to Mr. Gregg).
Apr.	16	JS 6 made.
May	21	Filed Deft's. Notice of Appeal (copy mailed to Mr. Gregg).

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Docket No. 71-1542

[Caption omitted.]

RELEVANT DOCKET ENTRIES

DATE	FILINGS—PROCEEDINGS	FILED
6- 1-71	Filed record (original papers of district court)	#
• • •		
11- 4-71	Argument heard (by: Waterman, Smith & Timbers CJJ)	
3-27-72	Judgment Affirmed, Waterman, CJ	
3-27-72	Filed judgment	
• • •		
4-26-72	Issued Mandate (opinion, judgment & statement of costs)	
6-26-72	Filed notice of filing of petition for writ of certiorari	(71-1665)
• • •		

Complaint.

[Caption omitted.]

(Filed May 14, 1968)

The plaintiff, appearing herein by his attorneys, Albrecht, Maguire, Heffern & Gregg, for his complaint against the defendant, alleges as follows:

FIRST: That this action is brought for the recovery of an estate tax under Section 1340 and Section 1346, Title 28, of the United States Code.

SECOND: That the plaintiff is the executor of the Estate of Ethel B. Bennett, who died on December 4, 1964, a resident of the Village of Alden, New York, the plaintiff having been duly appointed executor of said estate by the Surrogate of the County of Erie on the 6th day of January, 1965.

THIRD: That on or before the 4th day of March, 1966, the plaintiff, as executor of said estate, filed the federal estate tax return with the District Director of the Internal Revenue Service at Buffalo, New York, and paid the tax shown to be due thereon.

FOURTH: That said federal estate tax return reported numerous mutual funds or investment trust securities as being owned by said estate and subject to federal estate tax at values based upon the quoted prices at which they could have been sold on or about the valuation date.

FIFTH: That on or about the 20th day of November, 1967, the District Director of the Internal Revenue Service at Buffalo, New York, made a determination that said investment trust securities were includible in the gross estate for the purposes of the estate tax at values based upon prices the executor would have had to pay to purchase as many additional shares on the valuation date.

SIXTH: That this computation resulted in a valuation amounting to $8,925.27 in excess of the price at which such shares could have been sold on the valuation date.

SEVENTH: That the addition of $8,925.27 to the taxable estate at the 30% rate resulted in an additional estate tax amounting to $2,677.58, subject to adjustment for state death taxes in the sum of $214.21, or a net sum of $2,463.37.

EIGHTH: That on or before the 4th day of March, 1966, plaintiff paid the defendant the sum of $28,248.80; on or about the 6th day of October, 1967, the plaintiff paid the defendant the further sum of $11,635.37 as additional estate taxes; said total of $44,884.17 of estate taxes including the amount assessed on the higher valuation of said investment trust securities.

NINTH: That on or about December 5, 1967, plaintiff filed with the defendant a claim for refund in the sum of $3,092.59, subject to adjustment for state death taxes as stated in the claim for refund. A copy of said claim for refund is attached hereto as Exhiibt "A" and hereby made a part hereof.

TENTH: That on or about April 29, 1968, the defendant rejected said claim for refund. A copy of this notification from the District Director is attached hereto as Exhibit "B" and hereby made a part hereof.

ELEVENTH: That the said sum of $3,092.59 was illegally, erroneously and wrongfully collected by the defendant from the plaintiff for the reasons hereinafter set forth.

TWELFTH: That Section 2031 of the Internal Revenue Code provides that the value of the gross estate shall be determined by including "the value at the time of his death of all property, real and personal, tangible and intangible . . . ."

THIRTEENTH: That Reg. Sec. 20.3031-1(b) states that "the value of property includible in decedent's gross estate is . . . its fair market value at the time of the decedents death . . ." and that "the fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts."

FOURTEENTH: That the investment trusts, by quoting a price at which they are willing to purchase said shares each day, constitute a "willing buyer" and the tens of thousands of shares that are purchased by them each day show that this is the price at which willing sellers are willing to sell.

FIFTEENTH: That the price the plaintiff would have had to pay to purchase as many additional shares of all of the investment trusts owned by said estate on the valuation date is not a proper factor to be considered in determining the value of the shares it already owned.

SIXTEENTH: That although repayment of the said estate taxes and interest in the amount of $3,092.59 has been duly demanded with interest thereon from the date of payment, no part of said sum has been remitted or refunded and the full sum of $3,092.59 with interest thereon at the rate of 6% per annum from the date of payment thereof, subject to the adjustment previously noted, is due and owing to the plaintiff from the defendant.

WHEREFORE, the plaintiff demands judgment against the defendant for the sum of $3,092.59 with interest on $2,677.58, as adjusted for state death taxes from the 7th day of October, 1967, together with the costs and disbursements of this action.

ALBRECHT, MAGUIRE, HEFFERN & GREGG,
By RALPH J. GREGG,
Attorneys for Plaintiff,
1900 Liberty Bank Building,
Buffalo, New York 14202.

Answer.

[Caption omitted.]

(Filed July 11, 1968)

The defendant, by its attorney, Thomas A. Kennelly, Acting United States Attorney for the Western District of New York, answers the plaintiff's complaint as follows:

1. The defendant admits the allegations contained in paragraph 1 of the complaint.

2. The defendant is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 2 of the complaint.

3. The defendant admits the allegations contained in paragraph 3 of the complaint.

4. The defendant admits the allegations contained in paragraph 4 of the complaint.

5. The defendant admits the allegations contained in paragraph 5 of the complaint.

6. The defendant admits the allegations contained in paragraph 6 of the complaint.

7. The defendant denies the allegations contained in paragraph 7 of the complaint.

8. The defendant admits the allegations contained in paragraph 8 of the complaint.

9. The defendant admits the allegations contained in paragraph 9 of the complaint, except avers that the claim for refund was filed on or about December 6, 1967, and denies any statements contained in said Exhibit "A" unless otherwise specifically admitted herein.

10. The defendant admits that Exhibit "E" is a copy of a letter sent to plaintiff by the District Director but denies that said letter constitutes a formal notice of disallowance.

11. The defendant denies the allegations contained in paragraph 11 of the complaint.

12. The defendant admits the allegations contained in paragraph 12 of the complaint, except alleges that the proper wording of Section 2031 is "real or personal" instead of "real and personal."

13. The defendant admits the allegations contained in paragraph 13 of the complaint.

14. The defendant denies the allegations contained in paragraph 14 of the complaint.

15. The defendant denies the allegations contained in paragraph 15 of the complaint.

16. The defendant denies the allegations contained in paragraph 16 of the complaint.

WHEREFORE, the defendant demands that the plaintiff's complaint be dismissed and that judgment be entered for the defendant.

.........................,
United States Attorney.

Admissions as Requested by Plaintiff and as Revised by Defendant in his Answer to the Request.

[Caption omitted.]

(Filed February 22, 1971)

Set forth below, as an aid to the Court, are the statements which the plaintiff requested the defendant to admit as being true for the purposes of this action only and subject to all pertinent objections as to admissibility which might be interposed at the trial.

Some of these statements were admitted without change, some with qualifications. The qualifications requested by the defendant are shown below in (parentheses):

1. Redeemable shares of open-end investment companies have been subject to tax in estate subject to the federal estate tax since at least the year 1941, following the enactment of the Investment Companies' Act of 1940.

2. At least until the year 1961, the Internal Revenue Service accepted the net asset value or bid price as the value of such shares for estate tax purposes. (Prior to issuance of Treasury Decision 6680, C. B. 1963-2, 417, the Internal Revenue Service had no fixed position or policy on the valuation of shares in an open-end investment company. Some District Directors' offices accepted the "mean" price; others the "bid" price; and possibly others required the use of the "asked" or public offering price. See also Rev. Proc. 64-18, C. B. 1964-1, 681.)

3. In or about the year 1962 Revenue Agents began to assess deficiencies in estate tax unless such mutual fund shares were reported at the mean between the bid price and the public offering or asked price. (This did not necessarily reflect a uniform policy of the Internal Rvenue Service. Prior to the issuance of Treasury Decision 6680, C. B. 1963-2, 417, the Service had no fixed position or policy on the valuation of shares in an open-end investment company.)

4. On or about the 5th day of June, 1962, the Commissioner caused notice to be published in the Federal Register of his proposal to issue a regulation under Section 2031 of the Internal Revenue Code of 1954 that mutual funds should be valued at their replacement cost. Said notice announced that a hearing would be held on July 25, 1962, in the Internal Revenue Building at Washington, D. C.

5. The publication described in Paragraph 4 above was the first time the Internal Revenue Service had officially proposed to value mutual fund shares at replacement cost instead of at the liquidating value or bid price.

6. The proposed regulation was adopted by a Treasury Decision (6680) effective as to decedents dying on or after October 11, 1963.

7. Meanwhile, hundreds of proceedings were pending in District Directors' offices, Regional Commissioner's offices, the Tax Court and United States District Courts throughout the country in which executors were protesting the valuation of mutual fund shares either at the asked price or at the mean between the bid and asked price. (The defendant does not believe the pending proceedings would have numbered in the hundreds).

8. Included among the pending cases was an action commenced in the United States District Court for the Western District of New York by Robert M. Wink as Executor of the Estate of Addie G. Baldwin against E. C. Coyle, Jr. (District Director of Internal Revenue at Buffalo, New York) (Civil No. 9864) on August 23, 1962, to recover $3,090.95. This was the amount of estate taxes collected by the District Director on the grounds that mutual funds owned by the decedent (as of April 2, 1960) should be valued at the mean between the bid and asked prices. The amount of refund, adjusted for the credit of State death duties and interest to the date of payment, was $2,986.24. On January 14, 1963, the Assistant Attorney General in charge of the Tax Division of the Department of Justice authorized and directed the Chief Counsel of the Internal Revenue Service to refund to the plaintiff the amount he would have received (other than costs) had he prevailed in the litigation. On March 29, 1963, the Internal Revenue Service paid to the plaintiff the said sum of $2,986.24 with interest.

9. Also included among the pending cases was an action commenced in the United States District Court for the Western District of New York by Martha A. Metz as Executor of the Estate of Ethel Louise Stern v. E. C. Coyle, Jr. (District Director of Internal Revenue at Buffalo, New York) (Civil No. 10,167) on March (8), 1963. This was an action to recover ($2,840.28) of estate tax (subject to adjustment for the credit for state death taxes) collected by the District Director on the grounds that the mutual funds owned by the decedent (on February 22, 1961) should be valued at the "asked" price. On May 28, 1963, the Assistant Attorney General in charge of the Tax Division of the Department of Justice authorized and directed the Chief Counsel of the Internal Revenue Service to refund to the plaintiff the amount plaintiff would have received (other than cost) had she prevailed in the litigation. On August 9, 1963, the Internal Revenue Service paid to the plaintiff the said sum of ($2,840.28) with interest.

10. Also included among the pending cases was an action commenced in the United States District Court for the Middle District of Florida by Thomas Wilder and Horace D. Reigle, as Executors of the Estate of Charles M. Wilder against Laurie W. Thomlinson (District Director at Jacksonville, Florida) on October 11, 1963. One of the issues involved the sum of $18,619.98. This was the amount of estate taxes collected by the District Director on the grounds that the mutual funds owned by the decedent (on May 16, 1955) should be valued at the price the executor would have had to pay to purchase as many additional shares on the valuation date, *i.e.*, the asked price. The amount of refund adjusted for the credit for state death duties was $18,619.98. The claim involved another issue as to the value of real estate. On July 9, 1964, the Assistant Attorney General in charge of the Tax Division of the Department of Justice notified the plaintiffs that:

"(1) As to issue No. 1—*Valuation of Investments in Mutual Funds.* The government recede and accept valuation of such securities on the basis originally adopted by the executors (*i.e.* quoted prices at which such securities could have been sold on the valuation date), refunding to the Estate (after adjustment for state death taxes) the net sum of $18,619.98 together with interest at the statutory rate."

11. In 1964, the Commissioner settled the question in all cases pending involving persons dying on or before October 10, 1963, by instructing all taxpayers and Internal Revenue Service personnal that the Service would not disturb the values at which mutual funds had been reported in those estate (provided that if requested by the District Director, a collateral agreement is furnished by all interested parties that the value so determined would be treated by the executor and all distributees as the tax basis of any shares so valued. Rev. Proc. 64-18, *supra*).

12. The facts which are relevant to the valuation of mutual funds were no different after October 11, 1963, than they had been prior to October 11, 1963. (Defendant denies that) the only significance of the date October 11, 1963, is that this is the date on which the Commissioner formally announced that mutual funds owned by individuals dying before that date should be valued at the bid price, but that mutual funds owned by persons dying after that date should be valued at the asked price.

(Defendant admits that each of the following documents, attached hereto as exhibits, is genuine).

13. Letter dated January 14, 1963, from Department of Justice to Ralph J. Gregg, as Attorney for *Robert W. Wink as Executor of the Estate of Addie G. Baldwin v. E. C. Coyle, Jr.*, Civil No. 9864 (W. D. N. Y.).

14. Letter dated May 28, 1963, from Department of Justice to Ralph J. Gregg as attorney for *Margaret A. Metz as Executrix of the Estate of Ethel Louise Stern v. United States*, Civil No. 10,167 (W. D. N. Y.).

15. Letter dated July 9, 1964, from the Department of Justice to Thomas T. Cobb *re Thomas Wilder and Horace D. Riegle, Executors of the Estate of Charles M. Wilder v. Tomlinson*, Civil No. 63-211-J (M. D. Florida).

.................................,
Attorney for Plaintiff,
2110 Main Place Tower,
Buffalo, New York 14202.

UNITED STATES DEPARTMENT OF JUSTICE
WASHINGTON, D. C.

January 14, 1963

(SEAL)

Address Reply to the
Division Indicated
and Refer to Initials and Number
LFO:CMF:MJB:nvl
5-53-1877

Ralph J. Gregg, Esquire
Albrecht, Maguire, Heffern & Gregg
1900 Liberty Bank Building
Buffalo 2, New York

Re: Robert W. Wink, as executor of the Estate of Addie G. Baldwin v. E. C. Coyle, Jr., Civil No. 9864 (W. D. N. Y.)

Dear Mr. Gregg:

This refers to the above-entitled suit for refund of estate taxes.

This is to advise you that an administrative settlement has been approved on behalf of the Attorney General.

Accordingly, the Chief Counsel, Internal Revenue Service, has been authorized and directed to schedule an overpayment of such tax and assessed interest paid as the Service computes to be due under the issues raised by the pleadings, plus interest according to law. In other words, the overpayment will be in the amount plaintiff would have

received (other than costs) had he prevailed in this litigation. The amount of recovery demanded in the complaint, however, is not controlling, but is subject to the recomputation made by the Service.

Subject to the final paragraph of this letter, the refund check will be sent by the Service to the United States Attorney, Buffalo, New York, for delivery to the taxpayer or to the counsel of record. However, the refund check will not be so delivered until the United States Attorney has received from the taxpayer's counsel of record a stipulation calling for dismissal of the suit with prejudice and with the parties to bear their respective costs. Meanwhile, it is suggested that the stipulation be deposited in his office in order to avoid any delay in the delivery of the check and termination of the litigation at the appropriate time.

If the taxpayer has any unpaid liability in respect of an internal revenue tax, the overpayment resulting from this settlement may be credited in accordance with the provisions of Section 6402, Internal Revenue Code of 1954, and the interest on such overpayment will be allowed according to law.

Sincerely yours,

LOUIS F. OBERDORFER,
Assistant Attorney General,
Tax Division,

By: C. MOXLEY FEATHERSTON,
Chief, Review Section.

UNITED STATES DEPARTMENT OF JUSTICE
WASHINGTON, D. C.

May 28, 1963

(SEAL)

Address Reply to the
Division Indicated
and Refer to Initials and Number
LFO:CMF:MJBurruss:nvl
5-53-2032

Ralph J. Gregg, Esquire
Albrecht, Maguire, Heffern & Gregg
1900 Liberty Bank Building
Buffalo 2, New York

Re: Margaret A. Metz, as Executrix of the Est. of Ethel Louise Stern v. United States—Civil No. 10,167 (DC W. D. N. Y.)

Dear Mr. Gregg:

This refers to the above-entitled suit for refund of estate taxes by Margaret A. Metz as Executrix of the Estate of Ethel Louise Stern.

This is to advise you that an administrative settlement has been approved on behalf of the Attorney General.

Accordingly, the Chief Counsel, Internal Revenue Service, has been authorized and directed to schedule an overpayment of such tax and assessed interest paid as the Service computes to be due under the issues raised by the pleadings, plus interest according to law. In other words, the overpayment will be in the amount plaintiff would have

received (other than costs) had she prevailed in this litigation. The amount of recovery demanded in the complaint, however, is not controlling, but is subject to the recomputation made by the Service.

Subject to the final paragraph of this letter, the refund check will be sent by the Service to the United States Attorney, Buffalo, New York, for delivery to the taxpayer or to the counsel of record. However, the refund check will not be so delivered until the United States Attorney has received from the taxpayer's counsel of record a stipulation calling for dismissal of the suit with prejudice and with the parties to bear their respective costs. Meanwhile, it is suggested that the stipulation be deposited in his office in order to avoid any delay in the delivery of the check and termination of the litigation at the appropriate time.

If the taxpayer has any unpaid liability in respect of an internal revenue tax, the overpayment resulting from this settlement may be credited thereon in accordance with the provisions of Section 6402, Internal Revenue Code of 1954, and the interest on such overpayment will be allowed and paid according to law

Sincerely yours,

LOUIS F. OBERDORFER,
Assistant Attorney General,
Tax Division,

By: C. MOXLEY FEATHERSTON,
Chief, Review Section.

UNITED STATES DEPARTMENT OF JUSTICE
WASHINGTON, D. C. 20530

July 9, 1964

(SEAL)

Address Reply to the
Division Indicated
and Refer to Initials and Number
LFO:AMS:MJBurruss:nvl
5-17M-396

Thomas T. Cobb, Esquire
Black, Cobb, Cole and Crotty
444 North Beach Street
Daytona Beach, Florida 32015

Re: Thomas Wilder and Horace D. Riegle, Exrs. Est. of Charles M. Wilder v. Tomlinson—Civil No. 63-211-J (M. D. Florida)

Dear Mr. Cobb:

This refers to your offer dated February 28, 1964, as clarified by letter of March 20, 1964, submitted on behalf of the plaintiffs, to settle the above-entitled case on the following basis:

(1) AS TO ISSUE NO. 1—*Valuation of Investments in Mutual Funds.* The Government recede and accept valuation of such securities on the basis originally adopted by the Executors (*i.e.* quoted prices at which such securities could have been sold on the valuation date), refunding to the estate (after adjustment for state death taxes) the net sum of $18,619.98, together with interest at the statutory rate.

(2) AS TO ISSUE NO. 2—*Valuation of Real Estate.* The District Director and Executors agree to a compromise date of death value for the real estate of $55,000.00, refunding to the estate the net amount of overpayment of estate tax, based upon the compromise valuation figure, together with interest thereon.

(3) AS TO ISSUE NO. 3—*Interest on Deficiency Assessment.* Since the refund due the Estate under Items (1) & (2) will exceed the deficiency paid by the Estate on March 27, 1959, interest in the amount of $1,295.00, paid by the Estate on the alleged deficiency, will be refunded to the Estate, together with accrued interest.

(4) This offer, if accepted, shall be in full settlement of all claims for taxes against the Estate of whatsoever kind and nature, and, specifically, the government will agree that the income tax liability of the estate will not be subject to redetermination by reason of the settlement.

By letter of March 20, 1964 the fourth provision was clarified as follows: The settlement will embrace only those estate and income tax liabilities of the Estate of Charles M. Wilder, deceased, affected by a compromise settlement of the pending suit.

This offer has been accepted on behalf of the Attorney General subject to computation by the Internal Revenue Service of the amount due under the terms of settlement. Accordingly, the Chief Counsel, Internal Revenue Service, is being authorized to schedule an overpayment of such

tax and assessed interest paid as the Service computes to be due under the terms of the settlement, plus interest according to law.

Subject to the final paragraph of this letter, the refund check representing the overpayment will be sent by the Service to the United States Attorney, Jacksonville, Florida, for delivery to the taxpayers or to the counsel of record. However, the refund check will not be so delivered until the United States Attorney has received from the taxpayers' counsel of record a stipulation calling for dismissal of the suit with prejudice and with the parties to bear their respective costs. Meanwhile, it is suggested that the stipulation be deposited in his office in order to avoid any delay in the delivery of the check and termination of the litigation at the appropriate time.

If the Estate of Charles M. Wilder has any unpaid liability in respect of an internal revenue tax, the overpayment resulting from this settlement may be credited thereon in accordance with the provisions of Section 6402, Internal Revenue Code of 1954

Sincerely yours,

LOUIS F. OBERDORFER,
Assistant Attorney General,
Tax Division,

By: ABBOTT M. SELLERS,
Acting Chief, Review Section

Stipulation of Facts.

[Caption omitted.]

It is hereby stipulated and agreed by and between the parties hereto that for the purposes of this case the following statements may be accepted as facts, subject to the right of either party to object to the admission in evidence of such facts on the grounds of materiality or relevancy, and all exhibits referred to herein and attached hereto are incorporated in this stipulation and made a part hereof; provided, however, that either party may introduce other and further evidence not inconsistent with the facts herein stipulated.

1. At the time of her death on December 4, 1964, Ethel B. Bennett was the owner of shares of open end investment companies or mutual funds as follows:

(a) 2568.422 shares of Investors Mutual, Inc. in her individual name and 2067.531 in her name as trustee for Dorothy B. Cartwright.

(b) 2269.376 shares of Investors Stock Fund, Inc.

(c) 1869.159 shares of Investors Selective Fund, Inc.

2. The executor of her estate reported the value of these shares, for estate tax purposes, at their net asset value or "bid" (redemption) price and paid the estate tax computed on this basis. This value totalled $124,399.87.

3. The Commissioner of Internal Revenue assessed a deficiency in estate tax on the grounds that the value of these shares, for estate tax purposes, was the "asked" or public offering price. The Commissioner's determination was that these shares were includible in the gross estate

for the purposes of the estate tax at values based upon prices the executor would have had to pay to purchase as many additional shares on the valuation date. This value totalled $133,325.14.

4. On October 9, 1967, the Commissioner of Internal Revenue assessed a deficiency in estate tax against the Estate of Ethel B. Bennett for $11,635.37 plus interest thereon of $1,114.92 for a total of $12,750.29. The deficiency in tax represented the $8,925.27 adjustment in the value of the mutual fund shares and other adjustments not in issue in this case The deficiency in tax was paid on October 9, 1967; the interest on December 27, 1967.

5. On December 6, 1967, the plaintiff filed a claim for refund of federal estate taxes and interest in the amount of $3,092.59.

6. Investors Stock Fund, Inc., Investors Mutual, Inc. and Investors Selective Fund, Inc. (hereinafter sometimes referred to as "the investment companies") are open-end investment companies registered with the Securities and Exchange Commission, are subject to the regulations of said Commission and are regulated by the Investment Company Act of 1940, 15 U. S. C. § 80a-1, *et seq.* They were organized and are managed by Investors Diversified Services, Inc., Minneapolis, Minnesota. Investors Diversified Services, Inc. is not an open-end investment company. It acts as underwriter in marketing or distributing the shares of the investment companies it has organized and acts as investment manager for them.

7. Shares of these investment companies are marketed and distributed by Investors Diversified Services, Inc. (hereinafter referred to as "IDS") by prospectus pursuant to the Investment Company Act of 1940, the Securities Act of 1933 and the "blue sky" laws of the various states. Copies of the written prospectus issued on October 16, 1964 by Investors Stock Fund, Inc., Investors Mutual Fund, Inc. and Investors Selective Fund, Inc. are attached hereto as Exhibits A, B, and C. It is stipulated that these are true and correct copies of the prospectus by which shares of these investment companies were being offered in the regular course of business as of December 3, 1964.

8. The price at which shares of these investment companies may be sold to an investor is prescribed by § 22(d) of the Investment Company Act of 1940, 15 U. S. C. § 80a-22 to be the "current public offering price described in the prospectus". The current public offering price described in the prospectus of Investors Stock Fund, Inc., Investors Mutual, Inc. and Investors Selective Fund, Inc. is their "net asset value, ordinarily determined daily, plus a maximum sales charge of 8% of the public offering price" (lesser commission percentages apply for quantity sales). This is generally described as the "asked" price in the financial pages.

9. The "net asset value" is computed daily as of the close of trading on the New York Stock Exchange. The total assets are valued and the total outstanding liabilities, including all reserves and accrued expenses, are subtracted. The resulting net worth is divided by the number of shares outstanding to determine the "net asset value" per share of capital stock. This is generally described as the "bid" price in the financial pages.

10. Shares of these investment companies are distributed exclusively by IDS pursuant to distribution agreements with the investment companies. IDS is required by § 22(d) of the Investment Company Act of 1940, 15 U. S. C. § 80a-22, to sell shares in these registered investment companies at the current public offering price described in the prospectus (in this instance net asset value plus a maximum sales charge of 8% of the public offering price). IDS receives, in full payment for its services as distributor of these shares, a distribution fee equal to the amount by which the public offering price exceeds net asset value (a sales charge of a maximum of 8% of the public offering price with lesser percentages applying for quantity sales). The remainder of the purchase price is the "net asset value" which is remitted to the investment company. From its fee, IDS pays commission to its sales representatives and other expenses incident to or in connection with the distribution and sale of the investment companies stock.

11. Certificates evidencing share holdings may be issued by the investment companies, but, as a practical matter, they are generally not issued, but rather held by the investment company for the account of the owner.

12. As stated in each prospectus, the certificate of incorporation of each of these investment companies gives each registered shareholder the right to require the investment company to redeem his shares at any time at the redemption price described in the prospectus. Although there are no restrictions on the transferability of shares of these investment companies, the shareholders ordinarily dispose of them by requesting the company to redeem them.

13. The redemption price is the "net asset value" calculated as of the close of business on the day of receipt of the surrendered stock certificates or request to redeem by the shareholder.

14. There is no charge for redemption.

15. There are three ways by which a person may purchase shares from these investment companies, as follows:

(a) By an initial investment in shares offered by Investors Diversified Services, Inc.

(b) By directing the reinvestment of dividends and capital gains distributions on shares already owned in additional shares.

(c) By exchanging shares of one of these funds for shares of another of these funds.

16. A person who wishes to make an initial investment in such shares pays the "asked price" as defined in Stipulation No. 8 above.

17. A person who is already a shareholder of the investment company, by written authorization, may appoint IDS as his agent to reinvest his cash dividends and/or capital gains in additional shares of the respective investment company at the "net asset value" or "bid price" without any additional charge or sales commission.

18. Any shareholder has the right to transfer or exchange his shares in any one or more of these investment companies managed by IDS into or for shares of any of its other investment companies at "net asset value" or "bid price" without sales or service charge.

19. From June 7, 1950, to December 2, 1952, Arthur Y. Bennett, husband of the deceased, acquired 2203.632 shares of Investors Selective Fund, Inc. in Account No. *015*-0302717. He purchased 2013.33 of these shares at the "asked price" (net asset value plus sales charge). The remaining 190.299 shares were purchased for his account at "net asset value" or "bid price" by IDS pursuant to his authorization to reinvest his capital gains and dividends.

20. On December 2, 1952, Arthur Y. Bennett exchanged the 2203.632 shares of Investors Selective Fund, Inc. held for him in Account No. *015*-0302717 at their "net asset value" for the following shares at their "net asset value":

(a) 748.968 shares of Investors Mutual, Inc. (Account No. *027*-0302717).

(b) 632.540 shares of Investors Stock Fund, Inc. (Account No. *033*-0302717).

21. From December 2, 1952, to October 1, 1962, Arthur Y. Bennett acquired 1819.454 additional shares of Investors Mutual, Inc. in Account No. *027*-0302717 as follows:

(a) 984.074 new shares at the "asked price" ("net asset value" plus commissions).

(b) 43.206 shares by reinvestment of dividends and capital gains at the "net asset value" or "bid price".

(c) 792.174 shares as a two-for-one stock split declared on September 26, 1956.

This gave him a total of 2568.422 shares of Investors Mutual, Inc. in Account No. *027*-0302717 as of the date of his death.

22. From December 2, 1952, to October 1, 1962, Arthur Y. Bennett acquired 1636.836 additional shares of Investors Stock Fund, Inc. in Account No. 033-0302717 as follows:

(a) 463.392 new shares at the "asked price" ("net asset value" plus commissions).

(b) 38.756 shares by reinvestment of dividends and capital gains at "net asset value" or "bid price".

(c) 1134.688 shares as a two-for-one stock split declared on September 26, 1956.

This gave him a total of 2269.376 shares of Investors Stock Fund, Inc. in Account No. 033-0302717 as of the date of his death.

23. On May 5, 1961, Arthur Y. Bennett purchased 1869.159 shares of Investors Selective Fund, Inc. at their "asked price" ("net asset value" plus commissions). These shares were credited to him in Account No. 055-0302717. He owned these shares as of the date of his death on October 1, 1962.

24. In summary, as of the date of his death on October 1, 1962, Arthur T. Bennett owned:

(a) 2568.422 shares of Investors Mutual, Inc. (Account No. 027-0302717).

(b) 2269.376 shares of Investors Stock Fund, Inc. (Account No. 033-0302717).

(c) 1869.159 shares of Investors Selective Fund, Inc. (Account No. 055-0302717).

25. His ownership of these shares was reported in the federal estate tax return filed by the executor of the Estate of Arthur Y. Bennett and the estate tax was computed and paid on the net asset value or bid price as of the date of death.

26. The federal estate tax return filed for the Estate of Arthur Y. Bennett was examined by the Internal Revenue Service and the value of the mutual fund shares was accepted at the "net asset value" or "bid price" in October, 1964, on the stipulation that these values be used thereafter as their basis for income tax purposes. This acceptance was pursuant to Rev. Proc. 64-18, C. B. 1964-1, 1968, which had been issued in April, 1964.

27. The shares described in 24 above became the property of his surviving widow, Ethel B. Bennett, by virtue of the terms of his last will and testament.

28. In addition to the shares described above, Arthur Y. Bennett, during his lifetime, purchased 626.252 shares of Investors Mutual, Inc. at the "asked price" ("net asset value" plus a sales charge) for Ethel B. Bennett, as trustee for Dorothy B. Cartwright, their daughter. Thereafter, Mrs. Bennett, as trustee, purchased 814.431 shares at their "net asset value" or "bid price" by authorizing IDS, as her agent to reinvest the capital gains and dividends. The trustee also received 626.848 shares in a two-for-one stock split declared on September 26, 1956. This amounted to a total of 2067.531 shares credited to the account of Ethel B. Bennett in Account No. 047-0302717, transferred in 1962 to Account No. 067-0302717.

29. At the time of her death on December 4, 1964, Ethel B. Bennett was the owner, in her individual name, of:

(a) 2568.422 shares of Investors Mutual, Inc.

(b) 2269.376 shares of Investors Stock Fund, Inc.

(c) 1869.159 shares of Investors Selective Fund, Inc. and, as trustee of a trust for the benefit of her daughter, Dorothy B. Cartwright,

(d) 2067.551 shares of Investors Mutual, Inc.

30. Under the terms of the last will and testament of Ethel B. Bennett, a copy of which is attached as Exhibit D, she bequeathed 35% of the residue outright to her daughter, Dorothy B. Cartwright, and directed that the remaining 65% be held in trust for the life use of her daughter, Dorothy B. Cartwright, naming her grandson, Douglas B. Cartwright, and her granddaughter, Carolyn Tenney, as trustees and remaindermen.

31. The mutual fund shares owned by Ethel B. Bennett were distributed as follows:

(a) 2568.422 shares of Investors Mutual, Inc. to Douglas B. Cartwright and Carolyn Tenney as trustees for the benefit of Dorothy B. Cartwright.

(b) 979.376 shares of Investors Stock Fund, Inc. to Douglas B. Cartwright and Carolyn Tenney as trustees for Dorothy B. Cartwright.

(c) 1290.000 shares of Investors Stock Fund, Inc. to Dorothy B. Cartwright (the balance of the Investors Stock Fund shares).

(d) 1869.159 shares of Investors Selective Fund, Inc. to Douglas B. Cartwright and Carolyn Tenney as trustees for Dorothy B. Cartwright.

32. Douglas B. Cartwright and Carolyn Tenney as trustees requested the investment companies to redeem:

(a) 2568.422 shares of Investors Mutual, Inc. and

(b) 979.376 shares of Investors Stock Fund, Inc. and on February 19, 1969, these companies redeemed said shares at their "net asset value" or "bid price".

33. Dorothy B. Cartwright became the owner, on the death of her mother, of the 2067.531 shares of Investors Mutual, Inc. which had been registered in the name of her mother as trustee. Some of them are presently registered in her name and the rest are held in custodian account for the benefit of five of her grandchildren.

34. Dorothy B. Cartwright gave 430 shares of Investors Stock Fund, Inc. to Carolyn Tenney and 430 to Douglas B. Cartwright, keeping 430 shares in her own name. Carolyn Tenney and Dorothy Cartwright still own 430 shares apiece. Douglas Cartwright requested Investors Stock Fund, Inc. to redeem his 430 shares, and on November 7, 1966, these shares were redeemed at their "net asset value" or "bid price".

35. Attached as Exhibits E, F and G are the 1964 annual reports of Investors Mutual, Inc., Investors Stock Fund, Inc. and Investors Selective Fund, Inc. It is further stipulated that these are true and correct copies of the 1964 annual reports of these investment companies which were issued to the shareholders in the regular course of business

Unless the Court expressly orders otherwise, if the Court determines that plaintiff is entitled to any relief against defendant on its complaint, the parties will jointly compute the amount of the judgment in accordance with the Court's findings of fact and conclusions of law and submit the computation to the Court for its approval and entry of judgment; if the parties cannot agree on the proper computation, the Court will determine the amount of the judgment, and until such time, no final judgment shall be deemed to have been entered in this action.

RALPH J. GREGG,
Counsel for Plaintiff,

DONALD T. FISH,
Counsel for Defendant.

Official Report of Proceedings Held April 3, 1970.

[Caption omitted.]

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PROCEEDINGS

[Tr. 4] The Court: Mr. Knisley, you have the appearances. I understand both the taxpayer and the Government are ready in the case of Douglas Cartwright as Executor, against the United States. Is that true?

Mr. Gregg: Yes, sir.

Mr. Fish: Yes, sir

Colloquy Between Court and Counsel.

The Court: There is, as I understand, I saw a proposed stipulation of fact. Has that been executed?

Mr. Gregg: It has been executed, your Honor.

The Court: By the Government by Mr. Fish and by Mr. Gregg for the plaintiff, is that right?

Mr. Gregg: Correct.

The Court: All right. This shall be filed, Mr. White, with you. I will give it to you at the end.

Mr. Gregg: And in connection with it, there are six exhibits which are identified in the stips as A, B, C through G.

The Court: All right.

[Tr. 5] Mr. Gregg: The Court might like to have the clerk number them, but they are the items that we agreed on.

The Court: Mark those, each as a separate exhibit, Plaintiff's Exhibits 1 through 6.

Mr. Fish: Your Honor, the stipulation was executed with the reservation that all objections as to materiality and relevancy would be deferred until the time of trial and at the proper time I would wish to make objection.

The Court: I am sure some of the material there is not relevant or material, and if so, you object to it.

Mr. Fish: May I make specific reference to specific numbered paragraphs?

The Court: Yes.

Mr. Fish: All right. I would make objections to Paragraphs 19 through 28, inclusive.

The Court: Just a minute. Is this on the stipulation of fact?

[Tr. 6] Mr. Fish: Yes, your Honor.

The Court: All right. I will note your objection and reserve on it. You object to—

Mr. Fish: Paragraphs 19 through 28, inclusive, and Paragraphs 30 through 34, inclusive.

The Court: 19 to—

Mr. Fish: 19 through 28.

The Court: And what was the other?

Mr. Fish: 30 through 34.

The Court: All right. I will reserve decision.

Mr. Fish: Thank you, your Honor.

* * *

The Court: Let us identify for the record, each one of these exhibits and tell us what it is.

[Tr. 7] (Whereupon, a document described as 1964 annual report, Investors Selective Fund, Inc., a bond and preferred stock fund, was then marked as Plaintiff's Exhibit Number 1 for identification.)

(Whereupon, a document described as 1964 annual report, Investors Stock Fund, Inc., a common stock mutual fund, was then marked as Plaintiff's Exhibit Number 2 for identification.)

(Whereupon, a document described as Investors Selective Fund, Inc., Prospectus, October 16, 1964, was then marked as Plaintiff's Exhibit Number 3 for identification.)

(Whereupon, a document described as Investors Stock Fund, Inc., Prospectus, October 16, 1964, was then marked as Plaintiff's Exhibit Number 4 for identification.)

[Tr. 8] (Whereupon, a document described as 1964 annual report, Investors Mutual, Inc., the World's Largest Mutual Fund, was then marked as Plaintiff's Exhibit Number 5 for identification.)

(Whereupon, a document described as Investors Mutual, Inc., Prospectus, October 16, 1964, was then marked as Plaintiff's Exhibit Number 6 for identification.)

* * *

[Tr. 9] The Court: All right and the Government, you agree that these may be marked in evidence, and as to these, Mr. Fish, will you have some objection or arguments on relevancy or materiality?

Mr. Fish: If I understand correctly, your Honor, may I first state that for the three mutual funds which are involved in this case, what one through six represents are the annual reports for each of the three and the Prospectus for each of the three.

Mr. Gregg: That is right.

Mr. Fish: Your Honor, I would just say this, if any of those annual reports, your Honor, or Prospectuses contain matter which would be conclusiary in nature or be argumentative or contain legal conclusions—

The Court: Legal conclusions as to what the problem is, especially in this case you would object to [Tr. 10]it.

Mr. Fish: I would object to anything but the facts which are specific and particular facts which are in there.

The Court: I will reserve decision on those.

* * *

[Exhibits 1-6 admitted—Tr. 12-14]

* * *

[Tr.14] Mr. Gregg: Your Honor, there is already on file request for admissions. You know, the orginal.

[Tr. 15] The Court: Yes.

Mr. Gregg: And that was answered by the defendant. I combined them in one document which is agreeable to counsel for the defendant, so perhaps we could mark this as an exhibit or a submission to be part of the record.

The Court: I see. This coupled with your request and the answers.

Mr. Gregg: Right. It is relatively simple to do, but it is hard to work with.

Mr. Fish: Your Honor, we have certain objections. I believe the requests reserve the right to make our objections at the time of trial. We have certain objections to the numbered paragraphs of that request for admissions.

The Court: Do you want to make that statement now?

Mr. Fish: Yes, your Honor.

The Court: Would you hand that up, please. This will be filed in the file.

[Tr. 16] It is not an exhibit.

Mr. Fish: I would note that the Government objects to the following numbered requests for admissions, 2, 3, 7, 8, 9, 10, 13, 14, and 15. I would like to state that we objected, first that they are irrelevant and immaterial to the issues in this case and secondly, we would like to note that our position is that they do nothing more than reflect the uncertain situation which prevailed in this area as to valuation of mutual fund shares prior to the issuance of Treasury Decision 6680, which added the Section 20.2031-8 (b), to the regulations for estate tax.

The Court: Mr. Fish, as I read this document entitled "Admissions as Requested by Plaintiff and Revised by the Defendant in his Answers to the Requests", that the material in the parentheses is your comments upon the answers [Tr. 17] and would summarize the nature of your objections to each one of these?

Mr. Fish: Your Honor, may I state, for the record, I have not reviewed that particular document. I would state, though, that I assume that the court's files do contain the original request by the plaintiff and the defendant's answer with qualifications which would be the basis for these objections which I have made because I hadn't had a copy of the combined requests.

Mr. Gregg: Mr. Fish hadn't had a copy of it, but actually what I did was use the exact terminology that he wanted.

The Court: That he used in his defendant's answer to plaintiff's request for admission?

Mr. Gregg: Yes.

Mr. Fish: I would assume, your Honor, that the objections I just made on the record can be coordinated with [Tr. 18] that document you have there, your Honor, without any difficulty at all.

The Court: All right.

Mr. Fish: Your Honor, I would also note that the—

The Court: Just a minute, please, Mr. Fish.

Mr. Fish: Yes, your Honor.

The Court: Mr. White, also I will file at the end of the day with you, document entitled "Admissions as Requested by Plaintiff and as Revised by Defendant", and the answers of the defendant. That will be filed in the clerk's office. Go ahead, Mr. Fish.

Mr. Fish: All right, your Honor. I note as to the request for admission 12 the Government specifically denied Sentence 2 of that request. I would note that as to 13, 14, and 15, all the request asked was that we admit the genuineness of certain documents [Tr. 19] and we would specifically now note that these documents which we admitted to as being only genuine reflect nothing more than

administrative determinations and should not be before this Court, the documents and the matter contained therein, and as to any and all of these requests which are ultimately put in evidence or the Court feels should be in evidence, we assume that the Government's qualifications will be taken into consideration.

The Court: Right. In other words, as far as the Court considering the administrative determinations which were made in the Wink Case, the Mets Case and the Wilder Case, that those determinations shouldn't be considered by the Court.

Mr. Fish: I believe that there is substantial law to support the proposition, your Honor, that these are not judicial determinations; they are not Court determinations and they have no place in a proceeding such as this.

The Court: There are many reasons why we [Tr. 20] shouldn't go into them.

Mr. Fish: Right. It would actually probably not be the best thing for administrative—

Mr. Gregg: I would like to say in that connection, your Honor, that they do constitute admissions against interest. At least they can be so considered.

The Court: All right. I will reserve your objection on that.

Mr. Fish: Might I note just one more thing, your Honor, that those documents represent cases where the decedent died prior to October 11, 1963, and that would tie in with the Treasury Decision which applied to decedents who died after that date, and you will see the tie-in after you see the proof.

The Court: All right.

Mr. Gregg: While we have a good running record here of documents I believe counsel has no objection to the marking for identification and receipt in evidence of these three documents.

Mr. Fish: Your Honor, Mr. Gregg has stated that these certificates of incorporation [Tr. 21] were sent to him by the secretary of the three investment companies and we agree that these go into evidence, but I would request we be furnished copies of these documents.

The Court: All right. Mark those as separate exhibits, Mr. Gregg.

(Whereupon, a document described as a Certification by the Secretary of Investors Stock Fund, Inc., bearing date of February 26, 1970, was then received in evidence as Plaintiff's Exhibit Number 7.)

(Whereupon, a document described as a Certification by the Secretary of Investors Mutual, Inc., bearing date of February 26, 1970, was then received in evidence as Plaintiff's Exhibit Number 8.)

(Whereupon, a document described as a Certification by the Secretary of Investors Selective Fund, Inc., bearing date of February 26, 1970, was then received in evidence as Plaintiff's Exhibit Number 9.)

[Tr. 22] Mr. Fish: Thank you, your Honor.

The Court: Plaintiff's Exhibit Number 7 is what, Mr. Gregg?

Mr. Gregg: Certificate of incorporation of Investors Stock Fund. Number 8, of Investors Mutual.

The Court: Number 8 is certificate of incorporation?

Mr. Gregg: Certificate of incorporation, yes.

The Court: Of Investors—

Mr. Gregg: Mutual, Inc.

The Court: Mutual, Inc.?

Mr. Gregg: Yes. Number 9 is Investors Selective Fund, Inc.

The Court: Selective.

Mr. Gregg: Selective.

The Court: Not "service" but "fund", is that it, Mr. Gregg?

* * *

[Tr. 30] FRED COHN (8 Devon Lane, Williamsville, New York) a Witness called by and on behalf of the plaintiff, having been first duly sworn, was examined and testified as follows:

Direct Examination by Mr. Gregg:

The Court: Mr. Cohn, you will have to speak up in this courtroom. It is hard to hear.

By Mr. Gregg:

Q. You have already given your name and address to the clerk, have you, Mr. Cohn? A. Yes.

Q. First we would like to know your background and experience, where you work, what your duties are. Tell us where you work now? A. I work at Hugh Johnson and Company, members of the New York Stock Exchange.

Q. Located where? A. 1800 Rand Building, Buffalo.

Q. Could you give us a brief summary of your employment with them? A. I have been with Hugh Johnson Company since incorporation [Tr. 31] twenty years ago. I was Treasurer of the company until a couple of years ago and now I am Executive Vice President. We deal in all kinds of stocks and bonds, mutual funds and so forth.

Q. Did your experience in stocks and bonds pre-date the incorporation of Hugh Johnson and Company? A. Yes, about three years. I have actually been in the investment business for twenty three years.

Q. And with whom were you in investment business prior to the incorporation of Hugh Johnson? A. The George Bondwright Company, Incorporated, of Rochester, which is also a New York Stock Exchange member.

Q. How large is your firm over there now, Mr. Cohn? A. We have over two hundred employees, including about seventy, seventy-five salesmen.

Q. Did you specify what your office is now over there? A. I am Executive Vice President of the firm.

Q. And Hugh Johnson is the President of the company? A. He is the Chairman.

Q. Who is the president? A. The President is N. Michael Kaiser.

Q. Now,—

Mr. Fish: Your Honor, may I inquire at this time what will be the nature of Mr. Cohn's testimony?

[Tr. 32] The Court: Yes. That is why I asked you, Mr. Gregg. Can you explain to me what the purpose is of this witness' testimony this afternoon?

Mr. Gregg: One of the contentions of the Government and one of the things that has been a crucial point in the Court's decisions has been whether or not there is a free and open market, free willing buyer and seller situation in connection with the redemption of mutual funds. That is one point. Another point is the contention by the Government that the redemption of these shares is required by

law. This doesn't happen to be the case. There happens to be a very solid, strong business reason for it and this witness can give the Court the benefit of that testimony. Those are the two principal things.

The Court: All right.

Mr. Fish: Your Honor, may I state for the record—

The Court: Why don't we go ahead. We will hear the testimony. You can make your [Tr. 33] objections, Mr. Fish. Do you want to say something now?

Mr. Fish: Number one, your Honor, I do not believe that Mr. Cohn or Mr. Cohn's firm, Hugh Johnson and Company, engages in the sale of any of the mutual funds which are involved in this litigation, and number two, whether the shares, it seems rather clear to me from previous cases, whether these shares are redeemable as a matter of law or not, or as a matter of some other principle, is basically a legal conclusion and I think Mr. Johnson, as far as I can get out of what has been said so far, Mr. Johnson will be testifying only to legal matters and it is not proper.

The Court: Mr. Cohn.

Mr. Fish: Excuse me, I am sorry. Mr. Cohn. I apologize, and it is not proper.

Mr. Gregg: I don't propose to ask him any questions involving legal answers, your Honor.

The Court: I think that since he is here, Mr Fish, there is no jury here.

[Tr. 34] Mr. Fish: All right

The Court: We will listen to the testimony and then you may make your objections and motions to strike.

Mr. Fish: All right.

By Mr. Gregg:

Q. Now, what portion of your business over there at Hugh Johnson and Company has to do with mutual fund, mutual fund shares? A. We do about thirty per cent of our gross income is from mutual funds. It varies, of course, from year to year, but it is in that area.

Q. And about how many customers do you have that own mutual funds, approximately? A. Well, I couldn't give you an exact figure, but it numbers into the many thousands over the years that I have been with the firm.

Q. Now, Hugh Johnson is known for the Johnson Charts, is he not? A. That's correct.

Q. Do you happen to have a copy? I asked you to bring a copy with you. A. Yes, I have a copy.

Q. Would you explain to the Court the general format, purpose and contents of the Johnson Charts, which your Honor, do [Tr. 35] deal with mutual funds, including the Investors Diversified Services.

The Court: They do deal with the stocks which are the subject matter of this suit?

The Witness: Yes, they do

The Court: All right.

The Witness: Johnson's Charts is an annual publication which is sold to investment dealers and other financial, interested financial people throughout the country. This year we are publishing our twenty-second annual edition. The book of this year will

include full page performance charts on about one hundred ninety-three funds and other information on a total of four hundred ninety-one funds. It gives records, performance records of these funds for one year, two years, three years, four years, five years, ten years, fifteen, twenty and twenty-five years.

By Mr. Gregg:

Q. How long have you been associated with the preparation of the Johnson Charts? [Tr. 36] A. Right from the beginning. This will be the twenty-second issue that I prepared.

Q. Consecutively? A. Yes, sir.

Q. And what role do you play in connection with them? A. I have complete responsibility for the production of the charts.

Q. And you produce them by consulting various sources for various facts? A. That is correct.

Q. And what sources are they? A. Basically we get our information directly from the mutual funds involved, and then we also get economic and corporate information from the Department of Commerce, the Department of Labor, Bureau of Labor Statistics, the various associations such as savings bank associations, savings and loan associations, Standard and Poors reports, and so forth.

Q. Now, do you solicit and get information from Investors Diversified Services, and more particularly Investors Mutual Fund, Investors Stock Fund and Investors Selective Fund? A. Yes. Every one of those we have shown in our book ever since they were old enough to be shown.

[Tr. 37] Q. Now, if you are publishing charts and you say they are distributed throughout the country, you have

to contend in some way with the Securities and Exchange Commission? A. That is correct.

Q. In what way, if you would specify briefly.

Mr. Fish: Your Honor, that would be strictly legal. The Securities and Exchange Commission is outlined and provided by statute.

The Court: Well, I will reserve decision on that objection. Go ahead.

The Witness: Perhaps I could read a portion of the foreword. One paragraph in the foreword, which we consider particularly important and have it in red says all of the subject text, charts, illustrations and tables have been examined under all federal regulations and the statement of policy is amended November 5, 1957, issued jointly by the Securities and Exchange Commission and the National Association of Securities Dealers, Inc., and are on the opinion of counsel completely qualified under these regulations.

[Tr. 38] By Mr. Gregg:

Q. All right. Now, your charts deal in terms of value, do they not? A. That is correct.

Mr. Gregg: Your Honor, what I am getting at here is what is considered value in the industry, and this gentleman knows. Would you give—

Mr. Fish: Your Honor, let me state for the record the concept of values that Mr. Gregg is referring to and the point we are getting to is once again a matter of interpretation of the statute. It is a legal matter and has no relevancy here. He is not qualified to testify as to the value that was outlined in that statute.

The Court: Mr. Fish, on the other hand, the regulation, it must have some kind of a reason behind it and the reason must be based upon a number of factors, the statute, the industry if it is involved, so again I will reserve decision.

Mr. Fish: Thank you, your Honor.

The Court: Go ahead, Mr. Gregg.

[Tr. 39] Mr. Gregg: I think I'm going to ask to have the reporter read the question.

(Whereupon, the previous questions and answer were read as follows:

"Q. All right. Now, your charts deal in terms of value, do they not? A. That is correct.")

The Court: First of all, when you talk about value I think we should have your definition of value when you say "value". What do you mean by "value"?

The Witness: Why, value in mutual industry, we mean the actual net asset value of the shares of the mutual fund.

The Court: What do you mean by "net asset value"?

The Witness: Net asset value is the total of the market value of all securities owned by the fund and then the net asset value per share, if you want to go that far, is that same net asset value divided by the number of shares outstanding. In other words, the asset value is [Tr. 40] determined by the market value, most of which stocks would be on the New York Stock Exchange would be determined by the market value of all the stocks owned by the company.

The Court: I just wanted to be sure we are all using the same language. Go ahead, Mr. Gregg.

By Mr. Gregg:

Q. So when you are talking about net asset value per share you are talking about the undivided interest of the shareholder in the net asset of the company per share, is that substantially correct? A. Per share, that is correct.

Q. How do you show value in your charts? A. Well, our charts trace a $10,000 investment in the various funds for a ten-year period.

Q. Yes. A. We start out with a $10,000 investment and immediately show the value as $10,000 less the cost of acquisition, so right on the face of the chart, perhaps I should use Investors Stock Fund as long as we have it here. Investors Stock Fund in this particular period which ended just a year ago, December, shows $10,000 investment, initial asset value of $9,200, and then we show our line of [Tr. 41] performance starting that same percentage below the $10,000 mark.

Q. It starts at ninety two hundred? A. It starts at $9,200.

Q. Are all the figures that you request from these investment companies expressed in net asset value? A. That is correct. All the figures that we show, all the year-end figures, all the final figures are shown as net asset value figures.

Q. Now, is this something that the NASD and the Securities and Exchange Commission requires? A. Under the statement of policy which I mentioned earlier it is required that all so-called charts of record or charts which are used as what they call supplemental sales literature along with the prospectus must show net asset value and must show that immediately from the beginning.

Q. Have you examined the Investors Stock Fund prospectus and the Investors Mutual Fund prospectus that I gave you? A. Yes, I have.

Q. So that is why the, all the charts in there start at $9,200, illustrative of a $10,000 investment? A. That is correct.

Q. Based on your experience over these years, your sales load, that other 8 per cent, ever taken into account in determining value, in connection with your charts or in connection in the industry? [Tr. 42] A. No. The custom in the industry is to show value as net asset value after sales charges.

Q. Now, if you know, you can say. If not, you can say you don't know. What does the sales load go for? What is the,—what does that pay for? A. The sales load pays, basically it pays the salesman. Then in the case of a firm like ourselves—

The Court: Wait a minute, Mr. Cohen. The sales load pays for the sales load, is that it?

The Witness: No. You misunderstood me, your Honor. It pays the salesman.

The Court: And is there anything else out of that?

The Witness: In a case like ourselves,—this may be different from the Investors Diversified Services group. In the case of a retail firm like ourselves, the firm itself receives remuneration and out of that remuneration the salesman gets something and then the national distributor also gets a piece of that, so it pays for sales expenses of various types.

By Mr. Gregg:

Q. Now, in the case of Investors Diversified, in the case of [Tr. 43] Investors Stock Fund, we have seen from the exhibit here that the public offering price consists of net asset value plus a sales charge? A. Correct.

Q. Eight per cent in the usual situation subject to quantity discount? A. Right.

Q. Do you happen to know who gets the net asset value when the share is marketed? A. The net asset value goes to the fund itself.

Q. And the eight per cent goes to— A. The eight per cent in the case of IDS, I don't know specifically, but that is distributed by them in some manner.

Q. Now, based on your knowledge of the, that you have explained here, what is the purpose of having these redeemable shares?

Mr. Fish: Your Honor, that is highly objectionable. That is definitely fixed by statute, your Honor

The Court: I agree, Mr. Fish. It is hard for me to see the relevancy of that, but again I will hear it

Mr. Fish: I think we are getting into an area, your Honor, where we are mixing legal concepts with facts.

[Tr. 44] The Court: The purpose may not have anything to do with it, Mr. Gregg, but I will listen.

By Mr. Gregg:

Q. Why are they redeemable shares?

The Court: I will reserve

By Mr. Gregg:

Q. Where do they fit in the scheme of things? A. Well, from the point of view of a retail firm like ourselves it would be very difficult for a salesman to sell a mutual fund if the buyer did not know that he had marketability, and one of the major points, sales points of mutual funds is marketability and marketability of course means redemption and the redemption is guaranteed in one form or another by the fund.

Q. Now, only some companies have redeemable securities or redeemable shares, isn't that correct? A. Well, the open end companies or mutual funds have redeemable shares and then there are closed companies which do not have redeemable shares.

Q. And all of these are open end companies? A. All of the funds, mutual funds and all three funds of the IDS group that you are talking about here are open end, that is correct.

Q. You said that this gives them marketability but I didn't [Tr. 46] know whether you meant marketability or liquidity? A. Liquidity and marketability are terminology which are interchangeable.

Q. Can you explain to me why they need to have liquidity or marketability? A. I think I mentioned that briefly before, but a buyer of mutual funds or any other security would be, it would be very difficult to convince him to buy something if he didn't think that he could liquidate it if he needed the money.

Q. Yes. A. And I know in the case of funds that is a major sales point that we always explain to people that if they need the money they can always liquidate it at the then market value.

The Court: You can buy stock and do that.

The Witness: That is right.

The Court: Well, Mr. Cohn, would you explain to me please, I think we maybe ought to on the record now, these funds that were involved here are all open end?

The Witness: That is correct.

The Court: When you say "open end", again so that we make sure we are all using the same language, what is your definition [Tr. 46] of "open end"?

The Witness: An open end fund is one that will redeem its shares at the asset value and in most cases also continuously offer shares at net asset value plus sales charge.

The Court: All right. Open end, are they, are all of the open end funds, do they all have the same rules as far as how they shall be redeemed?

The Witness: I am not sure that I can say one hundred per cent, but in most cases, in almost every case the rules are very similar.

The Court: I see. Now again so we make sure we are all talking about the same thing, "closed end", what do you mean when you say "closed end"?

The Witness: Closed end fund sells a certain number of shares to the public and they do not redeem the shares. The shares then must be bought and sold on the open market, either over-the-counter market or as listed on an exchange like the New York Stock Exchange. For example, [Tr. 47] locally we have Niagara Share Corporation which is a closed end fund.

The Court: You buy that on the exchange?

The Witness: You must buy that on the exchange because they only have a limited number of shares outstanding and they are not selling more shares and the owner cannot sell them back to the corporation. He must sell them to another buyer.

The Court: None of the stocks or the funds we are involved with in this case, none of them are on the exchange?

The Witness: That is correct. They all redeem their own shares.

The Court: All right. Go ahead, Mr. Gregg.

By Mr. Gregg:

Q. You might explain, being a broker with a combination of mutual fund sales and regular stock sales, if you want to sell your shares of General Motors or so forth, how soon do you get paid for it or how soon are you supposed to get paid for it? A. Well, under the current regulations of the stock exchange you get paid in five business days or one full week.

Q. So that does represent liquidity? A. Correct. The same thing would be true of a mutual fund. [Tr. 48] If a customer of ours sold a mutual fund to us,—through us, not to us, but through us, we would also pay him in five business days.

Q. Yes. Now, closed end companies, as I understand, are also investment companies? A. That is correct.

Q. Now, do you know from your experience in this when the decision is made as to whether it is going to be a closed end company or an open end investment company? A. Well, that is usually made at the time the shares are offered

to the public. They say the offering company will say "we are offering so many shares and then the fund will be closed", and it is in the prospectus explaining that.

Q. Yes. Now, if they had, these shares had to trade on the open market instead of being redeemable shares; in other words, if they were kin to closed end companies rather than open end companies, are you able, based on your experience in the brokerage business, to tell us how they would sell with reference to net asset value generally?

Mr. Fish: Your Honor, he is posing a question that is posing a completely impossible situation and impossible to answer, and that is highly objectionable, if he says—

The Court: Well, again I will reserve decision. Go ahead. You may answer the question, Mr. Cohn.

[Tr. 49] Mr. Gregg: Would you, Mr. Reporter, repeat the final part of the question?

The Court: Mr. Knisley, would you repeat the question?

Mr. Gregg: Just the last few words.

(Whereupon, the pending question was read as follows:

"Q. Are you able, based on your experience in the brokerage business to tell us how they would sell with reference to net asset value, generally?")

The Witness: Yes. I believe so. In all of the years that I have been in the business, almost invariably, not one hundred per cent of the time but almost invariably, closed end funds sell at a discount from that asset value. In other words, lower than that asset value and often at a substantial discount.

I have seen closed end funds selling at as much as a twenty five, twenty to twenty five or even a thirty per cent discount from net asset value in certain market periods.

[Tr. 50] By Mr. Gregg:

Q. Does this put them at a disadvantage with open end companies? A. In my opinion it does. It is harder to sell a person a closed end company when he may get less than net asset value for those shares when sold.

The Court: On the other hand, there are some closed end companies on the market over net asset value.

The Witness: A few of them are, but not many. In most of the cases over the years, in the vast majority of cases over many, many years, they have sold at a discount.

By Mr. Gregg:

Q. Based on your twenty two years of experience with these mutual funds do you know of any instances of failure to redeem? A. None. No, sir, not any.

Q. Now, also in connection with your business have you had occasion from time to time to value mutual funds for the purposes, for estate tax purposes? A. Yes, we have.

Q. Would you please explain that? A. We have always felt that the value of mutual funds—

Q. First of all, what occasions have you had? [Tr. 51] A. Well, we have had, I would say over the years we have had hundreds of occasions to value funds, usually for attorneys who call up or executors who want valuations for estates.

Q. Yes. How did you value them for them? A. We have always felt that those should be valued and we have valued them at bid prices. However, in the last few years some attorneys have said the regulations have changed and asked us to value them at the offering price.

Q. Now, in those previous— A. We don't agree with that concept, but that is what they have asked us to do. Previous to that we always valued them at the bid price or the net asset value, which is synonymous.

Q. But it wasn't until two or three years ago that you were put on notice by some attorneys that they would want the ask price? A. A few years ago, yes.

Q. Have you had occasion to discuss value with owners of these funds on other occasions? A. Well, we quite often make inventories for customers and in every case where we inventory funds for customers we always show them at the net asset value.

Q. That would be for the purpose of valuing their portfolio? A. Of evaluation of the portfolio. We show individual stocks at market price as of a certain date and we show the [Tr. 52] mutual funds at net asset value as of that same date.

Q. Do you know of a public market for mutual fund shares? For example, well, let me put it this way. Do you know of any market, public or otherwise, where the estate of Ethel Bennett could have received more than the net asset value? A. There may be—

Mr. Fish: Your Honor, there is nothing in the record to show he is familiar with the estate of Ethel Bennett at this time and therefore there is not a proper foundation for this question.

The Court: I will overrule.

By Mr. Gregg:

Q. The question was do you know the market, public or otherwise—

The Court: What year is this now?

Mr. Gregg: '64.

The Court: '64. In the year '64.

The Witness: I know of none personally. It is always possible that there may have been one, but I know of none.

By Mr. Gregg:

Q. I have one more question for you. I asked you if you would be prepared to give us a quotation and identify [Tr. 58] values in connection with companies that went from no load to no load. Would you explain, first of all, what a load company is and a no load company? A. A so-called load company is the type of company to which we have been referring where the company is sold to the investor at net asset value plus a sales charge.

The Court: We are still only talking about open end companies?

The Witness: Now we are talking about open end companies, that's right. The sales charge is referred to commonly as the load. There are some companies in the country which sell at net asset value or are so-called no load companies. The quotation on a no load company, the offering price would be the same as the asset value or bid price.

By Mr. Gregg:

Q. Do you know of instances of this where, first of all, you can identify some no load companies, can you not? A. Oh, yes

Q. Could you give us the names of three or four? A. If I can refer to my book here.

Q. Sure. A. I can give you the names of quite a few more than that.

[Tr. 54] Q. Sure. A. Devgh Mutual Funds, Loomis Sales Mutual Fund, Pine Street Fund, One William Street Fund, Steinrow and Farnham Fund. There are several dozen more, if you want me to continue.

The Court: That should be enough.

By Mr. Gregg:

Q. Now, were any of those at one time load funds? A. Yes. One William Street Fund in particular was a fund that we were the original underwriting of it, about 1957 or 8. That had a full sales charge and then a few years later they eliminated the sales charge and it has been since a no load fund.

Q. And Hartwell and Campbell? A. Is another illustration of those, that's right.

The Court: Mr. Cohn, in a no load fund do you mean to say that no commissions are paid to salesmen, or what happens?

The Witness: That is correct. In fact there are really no salesmen, because a salesman will not go out and sell a fund if he cannot be paid for it. These are sold by advertising and so forth, other promotional methods.

The Court: Of course, the advertising cost—

The Witness: That is correct.

[Tr. 55] The Court: How does the company—

The Witness: The fund apparently feels that the management fee is sufficient to allow them to expend the money to advertise it.

The Court: That was the other question I had. In this eight per cent is the management fee included in the eight per cent?

The Witness: No, in no way. The management fee is taken out usually quarterly on a percentage basis of assets and that comes out of income.

The Court: That is true of all of the load, open end funds?

The Witness: No, load and no load funds, all investment companies.

The Court: Of course we can look at the prospectus here. Isn't it, isn't the investor told that out of that load that he is paying not only commission but he is also paying for management and expertise?

The Witness: The prospectus which is required by law to be given to the investor prior to his purchase explains that in detail, and I believe you have a copy of the [Tr. 56] various prospectuses here.

The Court: Yes.

The Witness: That explains that in detail. It explains what the sales charge or load is. It explains what the management fee is also and those are two different costs. The sales charges are paid for sales expenses and the management fee is paid to the management for continuing management of the portfolio.

The Court: The eight per cent is only for sales?

The Witness: That is correct.

The Court: And management comes out of income?

The Witness: Income.

The Court: From the various stocks in the funds?

The Witness: That is correct.

The Court: And then, of course, after that is taken out, then the value, net asset value to the owner then would be load less management fee?

The Witness: That is not quite correct. The net asset value is the total market value of all of the securties held by the fund. The management fee comes out [Tr. 57] of the income generated.

The Court: All right, fine. Very well. I see now.

By Mr. Gregg:

Q. I believe these Wall Street Journal quotations came from your files? A. That is correct.

Mr. Gregg: We tried to get them from the library, but it takes a week to get a print out from the Wall Street Journal.

Mr. Fish: Your Honor, the Government will stipulate—

The Court: You have already stipulated.

Mr. Fish: No, but on his representation, your Honor, if he is just trying to establish values reflected in the Wall Street Journal as of a given date, those can be put in the record.

The Court: They are in the record, aren't they?

Mr. Gregg: These have to go back to his office.

The Court: I mean in the stipulation of fact you have already agreed as to the—

Mr. Fish: No, this is not in there, your Honor.

The Court: This is something else.

[Tr. 58] Mr. Fish: Plus the fact Mr. Gregg in his brief referred to the figures he is now referring to, and

if I understand him correctly there was a little bit of discrepancy when those figures were checked out at the library.

The Court: I see.

Mr. Fish: What I am saying here is if it is just value of those funds on one day and then the value the next day, if Mr. Gregg wishes by letter form or whatever form he wishes to supply this for the Court, we will accept these figures.

The Court: Well, Mr. Cohn is here. Maybe we can continue.

Mr. Fish: If he knows.

By Mr. Gregg:

Q. Mr. Cohn, will you give the quotations and the dates for the particular fund? A. This is the mutual fund list, from the Wall Street Journal dated Friday, July 17, 1964 and in this list it shows One William Street. One William Street is quoted bid fourteen fifty eight; asked fifteen ninety three. Bid, of course, is not asset value. Asked is net asset value [Tr 59] plus sales charges. On July 20th—

Q. It had gone no load in the meantime? A. It had changed its policy and become a no load fund. On July 20th the quotation of One William Street is fourteen fifty five bid; fourteen fifty five asked.

Q. Now, the same with reference to Hartwell and Campbell? A. Hartwell and Campbell, became a no load fund in 1970. January 27th, Hartwell and Campbell was quoted thirteen ninety one bid; fifteen twenty asked. On January 28th Hartwell and Campbell is quoted thirteen eighty one bid; thirteen eighty one asked.

Q. That, and then in the meantime it had gone no load? A. That is correct.

Q. There is a three-day interval in that last one? A. It might be a weekend. No, on Hartwell and Campbell there is only one day. One William Street there is three days. It may have been a weekend.

Q. Wouldn't that show on the— A. Friday and Monday, yes it was. Friday to Monday.

Q. All right. A. And Hartwell and Campbell was the next day.

Q. You had an opportunity to review the, I thought perhaps you could help explain the relationship between Investors Diversified Services and Investors Stock Fund Mutual, etc. A. As I understand it, Investors Diversified Service—

[Tr. 60] Mr. Fish: Your Honor, I believe we have men from those companies who would be better qualified. He is not employed by the company.

The Court: Mr. Cohn, you say "I understand". You have some men here from the company, Mr. Gregg?

Mr. Gregg: Yes. He is quite familiar, your Honor, with the prospectuses. This is easy for him.

Mr. Fish: The prospectuses, your Honor, are in evidence. If he's going to testify to the workings of these particular companies—

The Court: Mr. Cohn, as I understand, you understand the function of these companies?

The Witness: Yes, sir.

The Court: All right. I will hear it.

The Witness: Investors Diversified Services is the sales organization of the sponsoring organization or the underwriter, whereas Investors Stock Fund, Investors Mutual and Investors Selective Fund are the investment companies themselves and Investors Stock Fund, for example, will [Tr. 61] sell its shares at net asset value to IDS, who will then sell these shares to the public at offering price.

Mr. Gregg: I think that is all.

The Court: Mr. Fish.

Mr. Fish: Your Honor, I believe the Government has made its objections before this gentleman testified, as to his testimony.

The Court: Yes.

CROSS EXAMINATION by Mr. Fish:

Q. Mr. Cohn, Hugh Johnson and Company does not sell shares in Investors Mutual, Inc. is that true? A. That is correct.

Q. Nor does it sell shares in Investors Stock Fund, Incorporated? A. Right.

Q. Nor does it sell shares in Investors Selective Fund, Incorporated? A. That's right.

Q. Now, stocks in those three funds are sold by whom? A. They are sold by the retail organization of IDS.

Q. When you say that you mean they are sold by Investors Diversified Services, Incorporated? [Tr. 62] A. Investors Diversified Services.

Q. Incorporated, correct? A. I believe so.

Q. All right, if you know. If you don't, just indicate you don't. A. I am quite sure that that is the case.

Q. Okay. Now, when you were making the term "value" synonymous, I believe, with the term "net asset value", correct? A. Correct.

Q. When you make reference to the term "net asset value", is that as it is used in the investment company act which defines net asset value, I believe? A. I don't think I am qualified to explain the investment company act.

Q. Do you feel you are qualified to explain the Securities and Exchange Commission act? A. I didn't say I was qualified to explain that.

Q. You are not an attorney, is that right? A. I am not an attorney, that's right. I don't want to give any kind of legal answers.

The Court: All right, Mr. Fish.

By Mr. Fish:

Q. All right. That is sufficient. I believe you said it that at times in the past you had opportunity to value open end investment company or mutual fund shares for [Tr. 63] purposes of estates or for other purposes? A. That's right.

Q. As part of your business, is that correct? A. That's right.

Q. Now, in effect when you value, when you said you valued them, you in effect took the bid or redemption price and that was the value placed on them, is that correct? A. That's correct.

Q. And if I understand you subsequently, you have also at times taken what I would call the public offering price or the ask price and value them at that, is that correct? A. We have done that upon the request of attorneys, but that is not—

Q. Let me ask you this: Did you do this, is the question I asked? A. We have done this.

Q. You have done it? A. We have done this.

Q. For purposes of business? I mean this is part of the business? A. For estate valuation, not for purposes of inventory valuation, no.

Q. No, but did you receive a fee for placing this value, let's say, on these shares? A. Not usually. We usually do that for no cost.

[Tr. 64] Q. For no cost? A. That is a service.

Q. Would this ever figure into part of the cost to a client or to an estate? Could it be considered you receive value for it? A. We usually only charge for an estate for transferring the securities from one name to another and that is a nominal charge of five or ten dollars.

Q. There is a charge? A. Which has nothing to do really with the valuation of the portfolio. It is just a transfer charge. It doesn't cover our cost, actually.

Q. If I were to call you today and say "Mr. Cohn, I have a client who has passed away and I would like you to value a certain number of shares in an open end investment company or mutual fund shares, will you value this for me", would you possibly charge me a fee for this valuation? A. We very seldom charge a fee.

Q. That wasn't the question. "Would you", is what I asked. Would you receive compensation for services? A. Not usually, not usually. Very seldom.

Q. When you say "very seldom", you could and you do? A. Well, could I explain it more fully?

Q. Surely.

The Court: Yes.

[Tr. 65] The Witness: Usually when we get a request for that it is from an attorney that has done business with us and we do it for him as a favor. It is very seldom that someone we don't know will call us up and ask us for this and on occasion where it is someone we never knew before or didn't know if we would ever do business with we may possibly charge a fee.

By Mr. Fish:

Q. Let me see if I get this straight. What I am trying to establish is that Hugh Johnson and Company as Hugh Johnson and Company through its authorized agents has valued mutual fund shares at the public asking price or at the asked price, is that correct?

Mr. Gregg: Your Honor, I object to the form of the question. The witness testified that they did this only at the request of the estate.

The Court: I will overrule it. I will hear it.

The Witness: Will you repeat the question?

By Mr. Fish:

Q. Yes. Is it a fair statement to say that Hugh Johnson and Company through its authorized agency or its officers has [Tr. 66] valued mutual fund shares on request at the asked price or what we call the asked price or the public offering price? A. Yes, we have.

Q. All right. Now, when you use the term "net asset value", is that to be taken as being synonymous with what we would call the bid or the redemption price for these shares? A. Yes, it is.

[Tr. 67] Q. Okay. Now let me ask you this, if you know; is it a fact that no load funds may charge up to a two per

cent premium over net asset value at the time of issuance of the security or at the time of redemption? A. If they charge at the time of issuance it would not be a no load fund. It would be maybe a low load, but not a no load fund.

Q. No. I say is it? To your knowledge do you know? A. I believe in the past some funds used to charge a small redemption fee of one per cent. I don't know if any still do.

Q. Well, if you know may no load funds charge up to two per cent as a premium, if you know? A. Whether they may legally or not I don't know.

Q. Okay. A. But in the past I know that they have charged as much as one per cent.

Q. As much as one per cent, okay. A. There have been rare instances, but it has been done.

Q. Now, Mr. Cohn, would it be a fair statement to say that the resale market value as far as open end investment company shares and mutual fund shares is concerned is a negligible, except for redemption by the issuing company? A. By "resale" do you mean "liquidation"?

Q. Yes, redemption? Do you know of any other way that the— [Tr. 68] A. I would say, I think it is a fair statement that you could say it is negligible, except for the issuing company. I am sure there have been cases where there have been purchases other than by the issuing company, but it is very small.

Q. This would be, is it correct, would be at what we call the redemption price? A. If other than the fund redeemed them they could redeem them at any price they wish.

Q. Do you know of any market for these mutual fund shares other than through redemption by the issuing company? A. I know of none. There may be one, but I know of none offhand. There are dealers, to carry that a little further, there are dealers, I believe, who may buy these. We would have to, I would have to refer to the over-the-counter sheets to verify that.

Q. Would it be still, is it still your testimony if it happened this way this would be a negligible occurrence? A. It would be a negligible amount.

Q. All right. Now, Mr. Cohn, does Hugh Johnson and Company ever act as, say, broker, underwriter, when you have a new issuance of common stock in a certain company? A. Yes.

Q. Now, would it be, when you have a new issuance of stock to the public and Hugh Johnson is the broker underwriter, [Tr. 69] what does the issuing corporation receive on the sale of the stock? A. The net,—the issuing corporation receives a price, an amount less than the offering price by the amount of the underwriting concession.

Q. All right. Now, is it true though that the underwriting cost would be reflected in the public offering price of the securities on the original issue? A. The original issue price includes the underwriting cost.

Q. They would be included in the public offering price, is that correct? A. That is correct.

Q. Would it be a fair statement, to say, Mr. Cohn, that when shares in an open end mutual or an open end investment company are bought— A. Purchased, do you mean?

Q. When they are purchased or when they are redeemed, that whether we are talking about the bid price or the ask price, that these prices are not subject to negotiation; is that a correct statement? A. That is correct.

Q. Okay. In other words, if I understand you correctly, if they are bought at the public offering price, is that correct? A. That is correct.

[Tr. 70] Q. Which is established how often, if you know? A. That is established once a day.

Q. Okay. A. In most cases.

Q. And the redemption price is the same, daily? A. It is established at the same time. The redemption price and the offering price is established by adding the sales charge on to the asset value.

Q. If you want to purchase these shares on a particular day there would be no element of negotiation entering into your attempt or your wish to buy these from the open end company, is that correct? A. That is correct.

Mr. Fish: No further questions, your Honor.

The Court: All right, Mr. Cohn. Thank you.

RE-DIRECT EXAMINATION by Mr. Gregg:

Q. Just one question, if I may. He asked you about a new underwriting and the fact that the sales commission and expense would be included in the new offering price. Could you tell us what happens to the market value of the shares after the shares have been issued? A. After the shares have been issued they, then when the marketing syndicate or the underwriting group is terminated which may be anywhere from an hour to several days later, [Tr. 71] the market value then seeks its own level. It may

go either up or down. In many cases it could be up four or five points or even double in some cases. It could be down two or three points.

Q. So fair market value is determined by the law of supply and demand after the issuance? A. That is correct, the law of supply and demand.

RE-CROSS EXAMINATION by Mr. Fish:

Q. In reference to that—

The Court: Do you mean this would be the underlying shares?

The Witness: We are talking now about individual stock underwriting.

By Mr. Fish:

Q. Right. A. Individual—

The Court: Oh, individual stock underwriting. All right.

By Mr. Fish:

Q. When you say that, of course you assume that those shares have been on the open market? A. When they become on the open market.

Q. Right. A. And the underwriting is over.

[Tr. 72] Q. Then you can negotiate for the purchase of those shares through a broker, is that correct? A. At that point the market value is determined by supply and demand, depending upon how many buyers and sellers.

Q. Then we have the normal, common stock situation where you purchase through a broker, is that correct? A. That's correct.

Q. And negotiation does fit into that concept, is that correct? A. Negotiation only to the point where it is very

close to the actual market value. If the market value is quoted eight to a half, somebody couldn't say "I am going to buy it for three" and expect to get anything, or four or five or six. It has to be in the area of the market, so negotiation would have to be very close to the market or there wouldn't be any business transaction.

Q. You are talking, if you were buying a large number of shares you would be talking about concepts of discounts and different values? A. Very likely if you buy a large number of shares you would pay more because you are increasing the demand.

The Court: Thank you, Mr. Cohn. Mr. Gregg, how long will your next witness be?

Mr. Gregg: Just to identify statistics I have put in my brief, your Honor. Maybe [Tr. 73] fifteen or twenty minutes.

The Court: All right. I want to make sure you have enough time. Take about a ten minute break.

Mr. Gregg: Very well, your Honor.

(Whereupon, at 3:40 p. m., a short recess was taken.)

Proceedings: After short recess, 3:58 p. m.

Appearances: As before noted.

Mr. Gregg: Your Honor, my next witness is Assistant Secretary of the three fund companies, Mr. Hartley.

GEORGE E. HARTLEY (6005 Abbott Avenue South, Edina, Minnesota) a witness called by and on behalf of the Plaintiff, having been first duly sworn, was examined and testified as follows:

Direct Examination by Mr. Gregg:

Q. Mr. Hartley, I identified you as Assistant Secretary of [Tr. 74] Investors Mutual, Investors Stock Fund and Investors Selective Fund. Was I right? A. Yes, sir. I am assistant secretary of those funds.

Q. I believe you may be assistant secretary of two others, or am I wrong? A. Yes, sir. Investors,—in the investors group there are six mutual funds and I am assistant secretary of each of the funds.

Q. Do you have any other title? A. I am also an employee of Investors Diversified Service, as I am director of funds accounting and service.

Q. Fine. Your Honor, in the cross examination of Mr. Cohn I think I misunderstood a question and the answer but as long as Mr. Hartley is here and knows the answer I would like to ask him to clarify the relationship between the funds and IDS, as far as the public offering price is concerned. Who is the buyer and who is the seller and what is their role in this transaction? A. Well, the mutual fund is the seller. Investors Diversified is the agent and the shareholder or customer is the buyer.

Q. I think he left the inference that Investors Stock Fund, for example, sold the shares to Investors Diversified Service which in turn then sold it to the public, but I don't believe that to be the case. Could you help us with that? [Tr. 75] A. No. His statement was incorrect on that point. Investors Diversified Service is an agent and does

not purchase the shares from Investors Stock Fund. It does at no time own those shares. It has a marketing function only.

Q. So that its interest is in this eight per cent load, am I correct? A. Yes, sir.

Q. Now, I asked you to bring along a breakdown of what happens to the load, because in your accounting services, your duties in connection with the allocation of funds inside Investors Diversified Services you should be able to tell us what happens to the load when it gets there. Do you have those figures so that you could give them to us in percentages or explain to us what happens? A. Well, you have those, Mr. Gregg. I can—

Q. This could be identified as an exhibit if the Court would like it. It is relatively short, however. A. Yes, sir.

Q. Now, we are starting with the proposition that—

Mr. Fish: Are you going to use that as an exhibit, Mr. Gregg, to refer to, because I haven't seen it.

Mr. Gregg: Let me let counsel see it here.

Mr. Fish: Your Honor, this makes reference to 1969. I don't believe 1969 is [Tr. 76] relevant in this case.

By Mr. Gregg:

Q. Do you have the 1964 figures? A. They are back with Mr. Delany.

Q. Did you prepare this exhibit, Mr. Hartley, or this document? A. No, sir. That was prepared under the direction of Mr. Ivan Hone, who is Assistant Comptroller for Investors Diversified Services. I questioned him as to

the source of his numbers and that report is a summary directly from the books and records of Investors Diversified Services.

Mr. Fish: What is the gentleman's name?

The Witness: Ivan Hone, H-o-n-e.

Mr. Fish: Did you ask Mr. Hone to make a study or a survey?

The Witness: I asked him for a set of figures on this particular subject, the amount of distribution fees received by Investors Diversified from the various fund companies and the disbursements made from that source of income.

Mr. Fish: Then Mr. Hone was the one who went to the books and records and got these figures?

The Witness: Well, it was done under his direction, [Tr. 77] and I am also,—well, I—

Mr. Fish: Just a minute. Did you do this?

The Witness: No, sir. They were prepared under the direction of Mr. Hone and he explained them to me and—

Mr. Fish: Your Honor, I would suggest that Mr. Hone would be the one qualified or competent to testify to this end result which is the result of his investigation.

The Court: Did you go over this with him?

The Witness: Yes, sir.

The Court: Is it correct?

The Witness: Yes, sir. This came from a report prepared in the comptroller's department of Investors Diversified Service. It is merely a summary.

The Court: All right. I will overrule the objection. Go ahead, Mr. Gregg.

By Mr. Gregg:

Q. Now, you have shown on this for 1963 and 4, but '64 is the year we are concerned with? A. Yes, sir.

Q. Can you tell us from this what disposition was made by IDS of the sales commissions it received during that year, and by item and either amount or percentage? [Tr. 78] A. Of the total distribution fees, commissions to salesmen amounted to 79.6 per cent. Divisional office fees which are expenses of our, in a distribution system and promotion amounted to 3.3 per cent. Advertising in the news media, publications and so forth, 3.7 per cent; prospectuses, annual reports, two per cent. Other departmental operating expenses, which are salaries and rental expenses allocated rent and so forth of other people in the home office who work on the distribution problem here, which is the back-up for the field force is 7.9 per cent, and miscellaneous, consisting of postage and so forth at 1.5 per cent, are the major items, constituting this.

Q. Does that total the hundred? A. Well, there is—

The Court: Excuse me, Mr. Gregg. Was this marked, this paper?

Mr. Gregg: No, it wasn't, your Honor.

The Court: Will you mark that, please. Let us have it marked. I will mark it in evidence and consider your objections and your motion.

Mr. Fish: Can I make one point, your Honor?

The Court: Yes.

Mr. Fish: This refers to years other than the years in suit. I believe it goes from,—[Tr. 79] what is the first year there?

Mr. Gregg: It goes from '63 to '69.

Mr. Fish: It goes from 1963 through 1969.

Mr. Gregg: It would be perfectly all right, as far as I am concerned, to wipe out reference to the other years.

The Court: Other years, all right. We will just consider it as to '64. It is going to be much more understandable to have it marked.

By Mr. Gregg:

Q. I really have one question in connection with this, your Honor, for the purpose of being,—you have enumerated the percentages. Does any portion of this distribution fee, sales commission, go for management or investment advisory services? A. No. That specific expense is specifically excluded from this allocation of expenses from this source of income. May I add though that I did not complete that list. There are items with very small percentage amounts which I did not read. Among the expenses are state and federal registration fees of .9 per cent.

Mr. Fish: Mr. Hartley, are you adding to that exhibit at this time?

The Witness: No, sir. I am just reading other items.

[Tr. 80] Mr. Fish: I thought you were writing on it.

The Witness: I read the larger percentages first. There is an item of group insurance which is the company's contribution to health and group insurance of .4 per cent; sales promotion literature .9 per cent; sales training expenses .4 per cent; all of which adds up to 100.6 per cent, which means that investors spent more on distribution than it got in fees.

Mr. Gregg: I would like to introduce that in evidence then, your Honor.

The Court: All right. Mark it in evidence subject to your objection and motion.

Mr. Fish: Yes, your Honor.

(Whereupon, a document described as IDS Analysis of Distribution Operations, years 1968-1969, bearing date of 4/1/70, was then received in evidence as Plaintiff's Exhibit Number 10.)

By Mr. Gregg:

Q. Now, Mr. Hartley, as assistant secretary of the corporation [Tr. 81] in charge of financial matters like this, you have to refer to the certificate of incorporation, do you not? A. Yes, I do.

Q. Can you tell us, based on your knowledge of things out there, when the decision was made to have redeemable shares? A. Well, that decision is made at the time the—

Mr. Fish: Your Honor, he hasn't laid a foundation, I don't believe, to establish when this gentleman came to work for this company.

The Court: How long have you been there, Mr. Hartley?

The Witness: I started my term of employment with Investors in 1965.

The Court: When were the funds founded or launched?

The Witness: Well, Investors Stock Fund was incorporated and founded in 1945. Investors Selective Fund in 1945 and Investors Mutual in 1940.

Mr. Fish: Based on that, your Honor, I don't believe he is qualified to testify.

The Court: From your experience in the firm do you know the answer to this?

[Tr. 82] The Witness: Yes, sir.

The Court: I will hear it subject to objection. Go ahead.

The Witness: In the certificate of incorporation which is a, the first document or a very preliminary part in organizing an open end mutual fund we draw up a certificate of incorporation and in that document we specify that we will redeem shares at the net asset value.

By Mr. Gregg:

Q. Are you referring to, this is Plaintiff's Exhibit Number 8. Will you find it in there and tell us the— A. In Article 4, sub-paragraph "C".

Mr. Fish: Your Honor, I submit that the Articles are in evidence and the provisions will speak for themselves if there is any reference to the provisions. They are in evidence.

The Court: If you want to refer in particular to the one marked there?

Mr. Gregg: Yes, your Honor, and I will just ask one preliminary question.

The Court: It might make it more clear in the record.

[Tr. 83] By Mr. Gregg:

Q. Is one of your duties the determination of the net asset value of the shares and the net asset value per share and the preparation of the financial reports of the company? A. Yes, sir. That is one of my main duties.

Q. Now, isn't it true that Article 4 C there is one of the rules that you have to abide by in your accounting practice? A. Yes, it is.

Q. And would you explain it there from Article "C", so we can see what the connection is here between this and your accounting procedures? A. Well, it states in Article "C" that the registered holder of shares of the company may require the company to redeem the same by delivering to the company at its principal place of business a written request therefore in a form satisfactory to the board of directors and the company upon receipt of such request and the surrender for redemption of the certificate or evidence of ownership of such stock at its principal place of business properly signed or endorsed shall pay promptly to or upon the order of the registered holder thereof the redemption price thereof. Shall I continue?

Q. No, and then the next paragraph says that it must be the net asset value per share, isn't that correct? A. Yes.

[Tr. 84] Q. And you are the person that determines, you are the person in charge of the accounting to determine net asset value per share? A. Yes, sir. That is all done under my direction.

Q. All right. Now I wish you might explain one other thing in connection with that certificate of incorporation. You will find dates in the right-hand margin. What do they signify, opposite certain paragraphs? A. Well, those dates signify that the paragraph was amended on that particular date.

Q. You can take this one.

Mr. Fish: The Government, your Honor, will stipulate that what is contained in the right-hand paragraphs here is apparently references to the date that the article was amended. That is what Mr. Gregg is saying.

By Mr. Gregg:

Q. Yes, and I have only one other thing. If no date appears opposite a paragraph does that mean that that has never been amended since the certificate of incorporation was drawn? A. Yes.

Q. Thank you. Now, do you know, based on your experience out there, when the certificate of incorporation is filed [Tr. 85] in relationship to the registration of the company with the Securities and Exchange Commission? A. Well, this certificate of incorporation precedes the registration with the Securities and Exchange Commission.

Q. Would you explain that? A. Well, it is necessary for a company to be incorporated and to have, well, a certificate of incorporation before it can apply for a registration before the Securities and Exchange Commission.

Q. Thank you. Now, do you know of any public market in which the estate of Ethel Bennett or any similar estate in 1940 could have—

Mr. Fish: Your Honor, I don't believe there is anything in the record to indicate he is qualified to so testify.

The Court: Isn't that almost agreed, there is no public market? There isn't any, is there, that you know of?

The Witness: No, sir, I don't know of any.

Mr. Fish: Your Honor, it doesn't make any difference, but I don't want to get into this area. He is an accountant

The Court: I wouldn't sustain it for that. I will listen to it. There isn't any, is there?

[Tr. 86] The Witness: No, sir, there is not.

By Mr. Gregg:

Q. Just to clarify one matter, you said you were assistant secretary of six corporations? A. Yes, sir.

Q. It is called to my attention that three of them are incorporated since you have been there, is that correct? A. Yes, sir.

Q. Which ones are they? A. That would be Investors Variable Payment Fund, Incorporated; IDS New Dimensions Fund, Incorporated, and IDS Progressive Fund, Incorporated.

Q. And you are assistant secretary of all those and have been from the beginning? A. Yes, sir.

Q. Did you handle the accounting work for them too? A. Yes, sir.

Mr. Fish: Your Honor, I don't mean to keep objecting, but these companies are not even subject to this litigation.

The Court: I know that.

Mr. Fish: They are not in suit. We are getting way off the beaten track.

The Court: All right

Mr. Gregg: Now, did you have people in your department prepare for you,—well, I [Tr. 87] will have this marked as an exhibit

(Whereupon, a document described as Indicating the Total Number of Shares Redeemed and the Total

Number of Shares Sold, was then marked as Plaintiff's Exhibit Number 11 for identification.)

By Mr. Gregg:

Q. Can you tell me what this represents, what it contains? A. This is a report made showing the total number of shares redeemed and total number of shares sold by Investors Stock Fund, Incorporated, Investors Mutual, Incorporated, Investors Selective Fund, Incorporated, for the years 1963 through 1969.

Q. How is it prepared and who prepared it? A. This report was prepared under my direction. It is taken directly from the books and records of the respective fund companies.

Mr. Gregg: I would like to offer it in evidence, your Honor.

Mr. Fish: No objection.

The Court: No objection. It may be received in evidence.

[Tr. 88] (Whereupon, a document described as Indicating the Total Number of Shares redeemed and Total Number of Shares sold, previously so marked for identification, was then received in evidence as Plaintiff's Exhibit Number 11.)

Mr. Gregg: That is all. Your witness.

The Court: All right.

Mr. Gregg: May I resume just a moment?

Mr. Fish: Sure.

(Whereupon, a document described as Containing the Heading "Investors Stock Fund", was then marked as Plaintiff's Exhibit Number 12 for identification.)

By Mr. Gregg:

Q. Mr. Hartley, I show you Exhibit Number 12 and ask you if you could tell us what this is and how it was prepared? A. This is a summary of the shares sold and redeemed by Investors Stock Fund, Incorporated, for each of the fiscal years beginning in 1963 through 1969, and it was prepared under my direction and I inspected the numbers and [Tr. 89] compared them to books and records of the Investors Stock Fund, Incorporated.

Mr. Gregg: I would like to have, may I examine the witness concerning this?

The Court: Surely.

By Mr. Gregg:

Q. Now, you have roughly total shares sold? A. Yes, sir.

Q. The total amount from the reinvestment dividends and capital gains distribution? A. Yes, sir.

Q. And then you have one called fund transfers and then the other asset value and public sales? A. Yes, sir.

Q. Now, would you explain to us what reinvest dividends means so that we can best understand this exhibit? A. When the fund company distributes income or capital gains to the respective share holders it offers to accept the amount of money back for the purchase of shares at net asset value. In effect, the dividends are reinvested in additional shares of the fund.

Q. Now, I notice in your exhibit that you have percentages. Is it correct that 12.66 per cent of the total shares sold are reinvestments of cash dividends and capital gains distribution? [Tr.90] A. Yes, sir, for the year 1963, yes, sir.

Q. '63. Let's go to '64. A. The amount of reinvested dividends in that year was 31.13 per cent of the total shares sold.

Q. So these are shares sold by the company at net asset value, is that correct? A. Yes, sir.

Q. Now, fund transfers, what does that mean? A. That is the amount of shares issued after a shareholder in another fund in the investors group liquidates his shares in the other fund and the proceeds is used to purchase shares in Investors Stock Fund at net asset value.

Q. So these are also sold at net asset value, correct? A. Yes, sir, they are.

Q. Now, asset value and public sales, what are those? A. Those are the number of shares that were sold as a result of solicitations and to employees and officers of the company.

Q. Now, these public sales are at, how are they computed here? Those are at net asset value? A. Those shares are the result of the net amount going to the Fund after the sales charge has been deducted.

Q. Now, percentage wise in 1964, 31.13 per cent of sales consisted of reinvestment of dividends at net asset value, correct? [Tr. 91] A. Yes, sir.

Q. 11.69 per cent of sales were as a result of transfers of shareholder from one fund to another at net asset value? A. Yes, sir.

Q. And 57.17 per cent is either to the public or to employees? A. Yes, sir.

Q. What percentage of that, roughly, would be to employees or their pension funds? It would be relatively small, wouldn't it? A. Yes, it would.

Mr. Gregg: All right. That is all the testimony I want.

The Court: This offered in evidence. You don't object?

Mr. Fish: No, your Honor.

The Court: All right.

Mr. Fish: The only objection I would make, it does contain figures which go beyond the year at issue, '64. If I understand, Mr. Gregg, that doesn't give you any particular trouble.

The Court: You agree the figures after '64 or not—

Mr. Fish: And the '63 figures.

The Court: Are not to be considered.

[Tr. 92] (Whereupon, a rocument described as bearing the heading "Investors Stock Fund", previously so marked for identification, was then received in evidence as Plaintiff's Exhibit Number 12.)

CROSS EXAMINATION by Mr. Fish:

Q. Mr. Hartley, on this Exhibit 11 I note that the number of shares sold in Investors Stock Fund, Inc. is, as of 10-31-64, is said to be 12,752,286, correct? A. Yes, sir.

Q. Now, if I understand correctly, were all of those shares sold at public offering or asked price? A. No, sir. That represents the total of all sales, reinvested dividends, fund transfers into the fund, sales at public offering and asset value sales, a total of all of them.

Q. Okay. The number of shares redeemed was 4,692,590? A. Yes, it was.

Q. Now, that means that that is the number of shares which the company redeemed, is that correct? A. Yes, sir.

Q. Now, to your knowledge was there any other, were any of these shares during this year sold at other than by the redemption method? A. I am sorry. I don't understand your question.

[Tr. 93] Q. All right. These shares were redeemed, is that correct? A. Yes, they were.

Q. Do you know of any other type of transfer sales as to these shares for that year? A. Well, that number of shares redeemed represents cash redemptions of the fund shares. Now, they could either represent cash paid to the redeeming shareholder or it could be that this was the cash value of the number of shares redeemed that is on the other side of the transfer going into another fund, but it represents in either event a cash redemption of this particular stock and is the total activity for that particular year.

Mr. Fish: Thank you very much, Mr. Hartley. I have no further questions of Mr. Hartley.

The Court: Mr. Hartley, thank you very much.

Mr. Gregg: I believe that concludes our case, your Honor.

The Court: Plaintiff rests. Do you have any testimony?

Mr. Fish: No, your Honor.

The Court: The Government rests.

Mr. Fish: Yes, sir.

* * *

District Court Judgment

[Caption omitted.]

[Filed April 16, 1971]

The Court, Honorable John T. Curtin, District Judge, presiding, having considered the evidence and the arguments of counsel, and having entered its findings of fact and conclusions of law herein, it is in conformity therewith:

ORDERED, that plaintiff have judgment against defendant for the principal amount of $2,699.41, with interest thereon at six percent according to law, together with costs as provided by law.

DONE IN OPEN COURT at Buffalo, New York, this 16 day of April, 1971.

............................,
United States District Judge.

Supreme Court of the United States

No. 71-1665

United States, petitioner

v.

Douglas B. Cartwright, as Executor of the Estate of Ethel B. Bennett.

Order Allowing Certiorari. Filed October 10, ..., 1972.

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second .... Circuit is granted.

☆ U.S. Government Printing Office: 1972—479-604/269

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In the Supreme Court of the United States

OCTOBER TERM, 1971

No.

UNITED STATES OF AMERICA, PETITIONER

v.

DOUGLAS B. CARTWRIGHT, AS EXECUTOR OF THE ESTATE OF ETHEL B. BENNETT

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit in this case.

OPINIONS BELOW

The opinion of the district court (Appendix A, *infra,* pp. 12-22) is reported at 323 F. Supp. 769. The opinion of the court of appeals (Appendix B, *infra,* pp. 23-33) is reported at 457 F.2d 567.

JURISDICTION

The judgment of the court of appeals was entered on March 27, 1972 (Appendix C, *infra*, p. 34). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether Section 20.2031-8(b) of the Treasury Regulations on Estate Tax, which provides that shares in mutual funds are valued for estate tax purposes at the public offering (asked) price, rather than the redemption (bid) price, is valid.

STATUTES AND REGULATIONS INVOLVED

The relevant provisions of the Internal Revenue Code of 1954 and of the Treasury Regulations on Estate Tax (1954 Code) are set forth in Appendix D, *infra*, pp. 35-40.

STATEMENT

At the time of her death on December 4, 1964, the decedent, Ethel B. Bennett, owned shares in three open-end investment companies (mutual funds) registered with and subject to the regulations of the Securities and Exchange Commission. Sections 1 to 53 of the Investment Company Act of 1940, c. 686, 54 Stat. 789 (15 U.S.C. §§ 80a-1 through 80a-52). A mutual fund is an organization which sells shares in itself, and uses the proceeds to invest and trade in securities. The fund issues as many of its shares

as can be marketed, and continually offers its shares to the public. It also continually offers to redeem its outstanding shares, as it is required to do by law (App. A. pp. 12-13; App. B, pp. 24, 26).

The price at which mutual funds offer their shares to the public (the "asked" price) is the net asset value, which is the fractional value per share of the fund's net assets, plus a sales load or sales charge. The sales load is a varying percentage of the offering price, dependent upon the quantity of shares purchased in a single transaction. The maximum sales load of the funds involved here ranged between seven and eight percent and the minimum was one percent.[1] The price at which mutual funds redeem their shares (the "bid" price) is the net asset value. In the normal course of business, all transactions for purchase or sale of shares of open-end investment companies, including the three herein, take place between the investor and the issuing company whose shares are involved (App. A, pp. 15-16; App. B, pp. 24-26).

On the decedent's federal estate tax return, the respondent executor valued the shares of the three funds at their redemption price on the date of the decedent's death. In accordance with Section 20.2031-8(b) of the Treasury Regulations on Estate Tax, the Commissioner determined that these shares should be valued at their public offering price on the date

[1] The investors in these funds also had the option to purchase additional shares with their dividends and capital gains distributions at the redemption or bid price (net asset value) (See App. A, p. 15).

of the decedent's death, and accordingly asserted an estate tax deficiency. After paying the tax, the respondent filed a suit for refund on the ground that Section 20.2031-8(b) is arbitrary, unreasonable, and inconsistent with Section 2031 of the Internal Revenue Code of 1954 (App. A, p. 13). Section 2031 requires inclusion in the gross estate of the "value" of all property owned by a decedent at the time of death. The district court agreed with the respondent and held the regulation invalid. The court of appeals affirmed (App. B, pp. 23-24).

REASONS FOR GRANTING THE WRIT

The regulation held invalid by the Second Circuit is reasonable and consistent with statutory law. There is a direct conflict among the circuit courts of appeal, and a resolution of that conflict is necessary to promote the orderly administration of related provisions of the estate, gift and income tax laws.

1. The decison below together with the recent decision of the Ninth Circuit (one judge dissenting) in *Davis* v. *United States*, rendered May 23, 1972, affirming 306 F. Supp. 949 (C.D. Calif.), is in direct conflict with decisions of the courts of appeals for the Sixth and Seventh Circuits.[2] In *Ruehlmann* v.

[2] The decision also conflicts with *Estate of York* v. *Commissioner*, 28 T.C.M. 1271, but is in agreement with *Hicks* v. *United States*, 335 F. Supp. 474 (D. Colo.), where no appeal was taken by the United States because of the dismissal of taxpayer's complaint on other grounds. *Hicks* is before the

Commissioner, 418 F. 2d 1302, affirming 50 T.C. 871, certiorari denied, 398 U.S. 950, rehearing denied, 400 U.S. 856, the Sixth Circuit sustained the Commissioner's regulation requiring mutual funds to be valued at their asked price for estate tax purposes. And the Seventh Circuit, in *Howell* v. *United States*, 414 F. 2d 45, sustained the gift tax counterpart of Section 20.2031-8(b) (Appendix D, *infra*, pp. 37-40), Section 25.2512-6(b) of the Treasury Regulations on Gift Tax (1954 Code) (Appendix D, *infra*, p. 40-41), which requires that mutual funds be valued at their asked price for gift tax purposes.

2. Because of the large number of persons who hold shares in mutual funds,[4] the valuation issue presented in this case is of very wide administrative significance. More than thirty cases involving this issue are pending, and now that two appellate courts have held for the first time that the Commissioner's method of valuation is invalid, it is likely that the number of cases will rapidly increase unless a definitive conclusion of the issue is reached.

3. Section 2031 of the Internal Revenue Code of 1954 (Appendix D, *infra*, p. 36) requires inclusion in the gross estate of the "value" of all property owned by a decedent. Section 20.2031-1(b) of the

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Tenth Circuit (No. 72-1360) on taxpayer's appeal. The issue is also pending before the Court of Claims in *Lyons* v. *United States*, No. 354-90, argued January 12, 1972.

[4] According to official figures on file with the Securities and Exchange Commission, the total value of open end load fund shares held by investors on December 31, 1971, was 45.5 billion dollars.

regulations (App. D, *infra*, pp. 37-39), implementing that provision, provides that the value of property in the estate is determined by reference to the "fair market value" of the property, which is defined as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts."

The underlying assumption of the "willing buyer-willing seller" rule is that the most realistic and appropriate value to place upon assets is the amount that the general public is willing to pay on the open market for the property in question. Consistent with this general formula for valuation, Section 20.2031-8(b) of the Regulations provides that mutual fund shares are valued at the "asked" price, *i.e.*, the price which a willing buyer would pay to acquire shares from the fund. Section 20.2031-8(b) is, in this regard, an application of the principle set forth in Section 20.2031-1(b) that the fair market value of an item sold at retail is its retail price; for example, the value of an automobile is the price at which the automobile would be sold to a member of the general public, not the lower price at which the automobile might be sold back to a dealer.

The concept of value reflected in Sections 20.2031-1(b) and 20.2031-8(b) has been approved by this Court in a series of cases in which the discrepancy between the cost of acquisition and the amount which could be realized on redemption of the asset in question was considerably greater than in this case. In

Guggenheim v. *Rasquin*, 312 U.S. 254; *Powers* v. *Commissioner*, 312 U.S. 259; and *United States* v. *Ryerson*, 312 U.S. 260, the Court held that the replacement cost of certain single-premium life insurance policies, rather than the substantially lower cash surrender value, determined the value of those policies for federal gift tax purposes. The courts below sought to distinguish these cases from the instant case on the ground that the insurance policies at issue in *Guggenheim*, *Powers*, and *Ryerson* contained certain features and privileges, such as the right to receive the face amount of the policy at death, which gave them an inherent value greater than the cash surrender value. This is, to some extent, true of the mutual fund shares at issue here, which, in addition to their cash redemption value, entitle the owner to use his ordinary income and capital gain dividends to purchase new shares in the fund at the "bid" price, *i.e.*, without paying the ordinary load charge (supra, p. 3, note 1).

In any event, the distinction drawn between the instant case and the decisions of this Court shows that the courts below failed to understand the basis of those decisions. The Court in *Guggenheim* did not question the willing buyer-willing seller rule then set forth in Treasury Regulations 79, Art. 19(1), nor did it question the notion that replacement cost is ordinarily the appropriate value to place upon property for tax purposes. The Court referred to the added value inherent in the special features of the single-premium insurance policies not in order to

restrict application of the Commissioner's approach to situations in which property has significant value beyond its cash redemption value, but, rather, in response to taxpayer's argument that "[T]he market for insurance contracts is usually the issuing companies or the banks who will lend money on them" and that "banks will not loan more than the cash-surrender value." The Court enumerated the other features of the policy in order to illustrate that "[a]ll of the economic benefits of a policy must be taken into consideration in determining its value * * *" 312 U.S. at 256-257, concluding that "[T]he value of these policies at the date of the gift was the amount which the insured had expended to acquire them. Cost is cogent evidence of value." 312 U.S. at 257-258.

It may well be that the Commissioner could have taken a different approach to determining "value" within the meaning of Section 2031. The Regulations might, for example, have provided for a determination of value based exclusively upon the amount which the estate would realize upon liquidation of the asset in question, rather than upon the amount which a purchaser in the public market would have to pay for the property.[4] It is well settled,

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[4] If the executor of the estate sold the mutual fund shares, it would be rare that the estate would be taxed on more than the bid price, because Section 20.2053-3 (d) (2) of the Treasury Regulations on Estate Tax (1954 Code) (26 C.F.R.) allows a deduction for the difference between the redemption price and the public offering price if the shares are sold in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution. If

however, that a Treasury regulation is not invalid merely because there is an alternative method of implementing the statute, but only if the method set forth in the Regulation is unreasonable of patently inconsistent with the statute. As the Court stated in *United States* v. *Correll*, 389 U.S. 299, 306-307:

> Alternatives * * * are of course available. Improvements might be imagined. But we do not sit as a committee of revision to perfect the administration of the tax laws. Congress has delegated to the Commissioner, not to the courts, the task of prescribing "all needful rules and regulations for the enforcement" of the Internal Revenue Code. 26 U.S.C. § 7805(a). In this area of limitless factual variations, "it is the province of Congress and the Commissioner, not the courts, to make the appropriate adjustments." *Commissioner* v. *Stidger*, 386 U.S. 287, 296. The role of the judiciary in cases of this sort begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the congressional mandate in some reasonable manner.

We submit that Section 20.2031-8(b) of the Regulations embodies a reasonable judgment by the Com-

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the shares are acquired by a beneficiary from the estate and sold by him at a price below the estate-tax valuation, the ensuing difference would be deductible as a loss for income tax purposes. Sections 1001 and 1002, Internal Revenue Code of 1954 (26 U.S.C.); Section 1.1014-1, Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.); *Levin* v. *United States*, 373 F.2d 434 (C.A. 1). In view of these provisions, there is little basis for respondent's contention below that the Regulation in question causes hardship to the owners of mutual funds.

missioner that the value of property, in this case mutual fund shares, is the amount that a willing purchaser would pay to acquire that property, and consequently, that the regulation is valid.

4. The valuation of mutual funds is important not only in the estate and gift tax area, but it also has a significant impact on income taxes. Section 1014 of the 1954 Code (Appendix D, *infra*, p. 35) provides that property acquired from a decedent shall take as its basis for income tax purposes the fair market value of the property as determined for estate tax purposes. Similarly, Section 1015 of the 1954 Code (Appendix D, *infra*, p. 35) provides that in certain situations the fair market value of properties acquired by gift determines the basis of those properties in the hands of the donee. Accordingly, the higher estate and gift tax yield from the Commissioner's method of valuing mutual fund shares may be partially or entirely offset by the higher tax bases of such shares for income tax purposes. Indeed, a relatively small fraction of estates actually pay any federal estate tax and relatively few gifts are so large as to be subject to the gift tax, but the higher income tax basis is allowed whether or not an estate or gift tax has been paid. Consequently, the fiscal impact of the method used for valuing shares of this type is probably not of great importance either to the Commissioner or to taxpayers as a class, who would generally prefer to used the asked price for income tax purposes and the bid price for estate and gift tax purposes. A definitive resolution

of the issue, however, is necessary in order to bring about a uniform method of valuation that can be applied in all three contexts.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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JUNE 1972.

APPENDIX A

In The
UNITED STATES DISTRICT COURT
For the Western District of New York

Civil No. 1968-164

Douglas B. Cartwright, as Executor of the Estate of Ethel B. Bennett, plaintiff

v.

United States of America, defendant

Opinion

This action was commenced by the plaintiff to recover $3,092.59 in estate taxes and interest. The dispute arose over the proper method of valuation of mutual fund shares in an estate tax proceeding.

Ethel Bennett died testate on December 4, 1964, owning the following shares in mutual funds:

Investors Mutual, Inc.	2568.422 (in her individual name) 2067.531 (in her name as trustee for Dorothy B. Cartwright)
Investors Stock Fund, Inc.	2269.376
Investors Selective Fund, Inc.	1869.159

Investors Mutual, Inc., Investors Stock Fund, Inc., and Investors Selective Fund, Inc. [hereinafter referred to as "the funds"] are open end investment

companies registered with and subject to the regulations of the Securities and Exchange Commission. They are regulated by Sections 1 through 53 of the Investment Company Act of 1940 [15 U.S.C. §§ 80 (a) (1) through 80 (a) (52)]. The funds were organized and are managed by Investors Diversified Services, Inc., not an open end investment company but the underwriter, distributor, and manager for the funds.

Upon the death of Ethel Bennett, her executor reported the value of the shares on the estate tax return at their net asset value, also called the bid or redemption price. The Commissioner of Internal Revenue assessed a deficiency on the estate tax, claiming that the estate tax value of these shares was the asked for or public offering price. The executor paid the deficiency on the accrued interest and, on December 6, 1967, filed a claim for refund of federal estate taxes and interest in the amount of $3,092.59.

The issue is whether Treasury Regulation 20.2031-8(b) (1963),[1] which requires that shares in mutual

[1] Sec. 20.2031-8

* * * *

(b) *Valuation of shares in an open-end investment company.* (1) The fair market value of a share in an open-end investment company (commonly known as a "mutual fund") is the public offering price of a share, adjusted for any reduction in price available to the public in acquiring the number of shares being valued. In the absence of an affirmative showing of the public offering price in effect at the time of death, the last public offering price quoted by the company for the date of death shall be presumed to be the applicable public offering price. If the alternate valuation under section 2032 is elected, the last public offering price quoted by the company for the alternate valuation date shall be the applicable public offering price. If there is no public offering price quoted by the company for the applicable valuation date (*e.g.*, the valu-

funds be valued for estate tax purposes at the public offering or asked price on the date of death, is reasonable. Plaintiff's position is that the shares should be valued at the redemption price.

The court has considered the extensive stipulation of facts, testimony of witnesses, and the briefs filed by the parties. The following constitutes the findings of fact and conclusions of law.

The regulation was held reasonable and its application by the Commissioner was upheld in *Estate of Wells* v. *Commissioner*, 50 T. C. 871 (1968) (six judges dissenting), aff'd as *Ruehlman* v. *Commissioner*, 418 F. 2d 1302 (6th Cir. 1969), and in *Howell* v. *United States*, 290 F. Supp. 690 (N. D. Ind. 1968), aff'd. 414 F. 2d 45 (7th Cir. 1969). However, in *Davis* v. *United States*, 306 F. Supp. 949 (1969), the court held that the regulation was unreasonable and found for the plaintiff. That decision is on appeal to the Ninth Circuit.

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ation date is a Saturday, Sunday, or holiday), the fair market value of the mutual fund share is the last public offering price quoted by the company for the first day preceding the applicable valuation date for which there is a quotation, adjusted for any reduction in price available to the public in acquiring the number of shares being valued. In any case where a dividend is declared on a share in an open-end investment company before the decedent's death but payable to shareholders of record on a date after his death and the share is selling "ex-dividend" on the date of the decedent's death, the amount of the dividend is added to the ex-dividend quotation in determining the fair market value of the share as of the date of the decedent's death. As used in this paragraph, the term "open-end investment company" includes only a company which on the applicable valuation date was engaged in offering its shares to the public in the capacity of an open-end investment company.

(2) The provisions of this paragraph shall apply with respect to estates of decedents dying after October 10, 1963.

If Treasury Regulation 20.2031-8(b) is reasonable, it must be upheld by the court [*United States* v. *Correll*, 389 U. S. 299, 306-307 (1967)], even if another method of valuing the shares would conform to the statute [*Mearkle's Estate* v. *Commissioner*, 129 F. 2d 386, 388-389 (3rd Cir. 1942)].

The price at which shares in the funds are sold to the investor is the current public offering price or asked price, which is determined by adding the net asset value and the load or sales charge. The net asset value of a share is computed by adding the market value of all securities and other assets owned by the fund and subtracting the liabilities of the fund and dividing that figure by the then total outstanding shares. The load charge usually covers the cost of expenses and profit to the broker,[3] but does not include any management fee. The redemption price or bid price is the current net asset value and does not include the load charge. Ethel Bennett acquired her shares by gift, inheritance, and by purchase at the bid price by reinvesting her capital gains and ordinary dividends. She did not acquire any shares by purchase at the asked price.

If an individual acquires shares in the funds through purchase, he realizes at the time of the original acquisition that he is paying a load charge. He further understands that, if he later wants the

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[3] Shares of some mutual funds may be purchased at a public offering price equal to the net asset value. There is no load charge because the companies maintain no dealer organization or staff of sales representatives. Investors are not solicited but must apply directly to the underwriter. The shares of Scudder, Stevens & Clark Fund, Loomis-Sayles Fund, and Stein, Roe & Farnham Fund may be purchased without a load charge.

company to redeem the shares, they will be redeemed on the date of redemption at the net asset value. There are no restrictions on the transferability of shares in the funds, but they are not sold in the securities market. The ordinary and only practical method of disposition is redemption. If the holder disposes of these shares during his lifetime, tax computation is based upon net asset value.

Provisions similar to Section 2030(a) of the Internal Revenue Code of 1954 [26 U. S. C. § 2030(a)], which requires that the gross estate of a decedent shall be determined by including the value of all of his property at the time of death have appeared in the Revenue Act since 1916. Prior to the promulgation of Regulation 20.2031-8(b) (1963), effective after April 10, 1963, there was no regulation specifying how shares in mutual funds should be valued for estate tax purposes. From 1940, when the Investment Company Act became effective, until the early 1960's, the Commissioner had no fixed policy for the valuation of mutual funds. During this period of time, the taxpayer could value the shares at redemption price if he desired. In about the year 1962, some Revenue agents demanded that mutual fund shares in estate tax returns be valued at the asked price or at the mean between the bid and the asked price. However, after taxpayers filed refund actions, the government accepted the bid prices as the fair market value and settled the case.[3]

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[3] The following are some examples of cases the government settled: Two actions were started in the United States District Court for the Western District of New York. In *Wink, as Executor of the Estate of Baldwin* v. *Coyle*, Civil 9864, the Commissioner valued the shares on the mean between the bid and the asked price. In *Metz, as Executor of the Estate of*

The government bases its argument of reasonableness of Treasury Regulation 20.2031-8(b) (1963) on several grounds. The first is that the regulation applies the general principle of valuation expressed in Treasury Regulation 20.2031-1(b) to the valuation of mutual funds shares. Secondly, it brings the valuation of these shares into harmony with cases like *Guggenheim* v. *Rasquin*, 312 U. S. 254 (1941), which held that replacement cost rather than cash surrender value is the correct measure of value of a single premium insurance contract. Thirdly, the argument for reasonableness is based on the fact that no hardship is imposed on the estate or the beneficiaries if they dispose of the shares at a loss. Treasury Regulations Section 20.2053-3(d) (2).[4]

Stern, Civil 10,167, the Commissioner valued the shares at the asked price. On October 11, 1963, the case of *Estate of Wilder* v. *Tomlinson* was filed in the Middle District of Florida. All three cases were settled by the refund to the taxpayer of the excess tax collected.

[4] Sec. 20.2053-3(d)

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(2) Expenses for selling property of the estate are deductible if the sale is necessary in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution. The phrase "expenses for selling property" includes brokerage fees and other expenses attending the sale, such as the fees of an auctioneer if it is reasonably necessary to employ one. Where an item included in the gross estate is disposed of in a bona fide sale (including a redemption) to a dealer in such items at a price below its fair market value, for purposes of this paragraph, there shall be treated as an expense for selling the item whichever of the following amounts is the lesser: (i) the amount by which the fair market value of the property on the applicable valuation date exceeds the proceeds of the sale, or (ii) the amount by which the fair market value of the property on the date of the sale exceeds the proceeds of the sale. The principles used in

The government, citing *Commissioner* v. *South Texas Co.*, 333 U. S. 496, 501 (1948), argues that, since the "Regulations constitute a contemporaneous construction by those charged with the administration of the revenue statutes [it] should not be overruled except for weighty reasons."

The general principle of valuation expressed in Treasury Regulation 20.2031-1(b) defines fair market value as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." The government's position is that the only time that the willing buyer-willing seller situation exists in the sale of mutual fund shares is at the time of original sales by the investment company to purchaser. At the time of redemption sale, since the company is under an obligation of law to purchase at the net asset value, it is not a willing buyer, and quite often, since the circumstances of the owner of the shares compel the sale, he is not a willing seller.

This theory disregards the facts of acquisition in many cases, including this one. Mrs. Bennett acquired her shares either by gift, inheritance, or by acquisition at the redemption price, and none at the asked price. It also disregards the fact that, at the time of original purchase, the buyer is fully aware that, at the time of sale back to the company, he will be able to sell the shares back at the net asset value or redemption price, whatever it may be at that time. At the time of original purchase, both the buyer and seller are fully

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determining the value at which an item of property is included in the gross estate shall be followed in arriving at the fair market value of the property for purposes of this paragraph. See §§ 20.2031-1 through 20.2031-9.

cognizant of the facts and willingly enter into the transaction.

As the court pointed out in *Davis* v. *United States*, *supra*, there are two separate markets. The difference in the price in the two markets is the sales commission. To include that in the value of the shares to the estate creates an artificial value that cannot possibly be obtained by the estate in any readily accessible market. The sales commission is for the expense of advertising and marketing only, and adds nothing to the value of the share.

In order to show the reasonableness of the regulation that replacement cost of the mutual fund share, rather than the redemption price, is the correct measure of value, the government cites *Guggenheim* v. *Rasquin*, *supra*. In that case, the taxpayer purchased a single premium life insurance policy for $852,438.50 at the face value of $1,000,000.00. A short time later, she gave the policy to her children. On the gift tax return, she listed the policies at their cash surrender value of $717,344.81. The Commissioner's valuation of the gift at cost of $852,438.50 was upheld by the Supreme Court. The Supreme Court was persuaded by the facts that the owner of the fully paid life insurance policy not only had the right to surrender it, but the right to receive the face amount of the policy upon the insured's death. The court pointed out:

> "An important element in the value of the property is the use to which it may be put. Certainly the petitioner here did not expend $852,438.50 to make an immediate gift limited to $717,344.81. Presumptively the value of these policies at the date of the gift was the amount which the insured had expended to acquire them."

The government argues that *Guggenheim* stands for the principle that, in valuing mutual fund shares, not only the redemption price but the entire bundle of rights which the estate receives must be taken into account. The bundle of rights in *Guggenheim* included the right to receive the face value of the policy at the time of death, and a certainty of insurance coverage if Mrs. Guggenheim became uninsurable.

It appears to this court that the Commissioner's attempt to remold the facts and law of *Guggenheim* to fit the problem of valuation or mutual fund shares is unrealistic and unreasonable.

No doubt there are advantages in holding mutual funds, but mutual funds and insurance policies are so different that the bundle of rights in each cannot be compared.

The value of mutual fund shares fluctuates with the stock market, but an insurance contract has a fixed value. An individual may purchase mutual funds whatever his age or his state of health. However, the question of insurability is an important consideration both to insurance companies and to the holders of insurance policies. Because it is difficult for many individuals to obtain life insurance coverage, the purchase of a life insurance policy is a valuable right. There is no comparable consideration in the purchase of mutual fund shares.

The event of death itself brings about no change in value of a mutual fund share. No payment of any kind is made unless the estate or beneficiary presents the share for redemption. On the other hand, when death occurs, the insurance company pays under the policy, the estate tax is paid, and that is the end of it. Mutual fund shares can pass from estate to estate with a tax paid on each transfer. By Regulation

20.2031-8(b) (1963), the government collects an added tax on the load charge at the time of each transfer. Is it reasonable for this tax to be paid again and again, imposed on the load charge, which adds nothing to the value of the share but pays only for marketing and advertising costs?

The government's argument that no hardship is imposed upon the estate or beneficiaries by this regulation if they dispose of the shares is not convincing. Treasury Regulation 20.2053-3(d)(2), which provides that, if the shares are sold at a loss, the loss is a deductible expense of administration, is of no benefit to the estate or to the beneficiary which does not sell the shares. Furthermore, as the dissent points out in *Wells* v. *Commissioner, supra,* the loss may be taken only under certain limited circumstances. In addition, if the regulation setting fair market value is unreasonable, this unreasonableness cannot be cured by a regulation which limits the hardship imposed upon a taxpayer.

History lends little support to the government's argument that the regulation was designed to bring the valuation of mutual fund shares into harmony with such decisions as *Guggenheim* v. *Rasquin, supra; Powers* v. *Commissioner,* 312 U. S. 259 (1941); *United States* v. *Ryerson,* 312 U. S. 260 (1941); and *Dupont Estate* v. *Commissioner,* 233 F. 2d 210, cert. denied, 352 U. S. 878 (1956). Three of these cases were decided in 1941, and the *Dupont* case, decided in 1956, merely applied the rationale of the *Guggenheim* gift tax case to an estate tax case.

In similar fashion, it is clear that the regulation cannot be deemed a contemporaneous construction of the statute. The statutory definition of value has been

in the Revenue Act since 1916, and this regulation was not promulgated until 1963.

For these reasons, the court determines that Treasury Regulation 20.2031-8(b) (1963) is unreasonable. Judgment shall enter for the plaintiff.

Prepared judgment on notice.

So ordered.

JOHN T. CURTIN,
United States District Judge.

Dated: February 22, 1971.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 73—September Term, 1971.

(Argued November 4, 1971 Decided March 27, 1972.)

Docket No. 71-1542

DOUGLAS B. CARTWRIGHT, as Executor of the Estate of ETHEL B. BENNETT, PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

Before:

WATERMAN, SMITH and TIMBERS,
Circuit Judges.

WATERMAN, *Circuit Judge:*

We are called upon to decide whether Section 20.2031-8(b) (1963) of the Treasury Regulations on Estate Tax (1954) which requires that shares of open-end investment companies (mutual funds) are to be valued for estate tax purposes at the public offering or publicly posted asked price is a reasonable regulation. The issue reaches us by a government appeal from a decision of Judge John T. Curtin in the United States District Court for the Western District of New York, reported at 323 F. Supp. 769 (1971), in which the district court held that the

regulation was unreasonable. We agree with the court below and affirm the judgment below.

We need not belabor the facts involved in this dispute for they are well set out in the lower court opinion. Ethel Bennett died testate owning shares in three mutual funds which are registered with, and subject to the regulations of, the Securities and Exchange Commission. Upon her death the executor of her estate, Douglas B. Cartwright, filed an estate tax return reporting the value of those shares at their net asset value,[1] that is, at their bid or redemption price. As we have noted, Treasury Regulation 20.-2031-8(b), set forth in the margin,[2] requires that shares in such funds be valued at their public offering price, and, accordingly, the Commissioner of Internal Revenue assessed a deficiency. The executor

[1] Though the term "net asset value" is fairly self-explanatory, the parties also stipulated to its meaning:

> 9. The "net asset value" is computed daily as of the close of trading on the New York Stock Exchange. The total assets are valued and the total outstanding liabilities, including all reserves and accrued expenses, are subtracted. The resulting net worth is divided by the number of shares outstanding to determine the "net asset value" per share of capital stock. This is generally described as the "bid" price in the financial pages.

[2] Regulation 20.2031-8(b) reads:

> (b) Valuation of shares in an open-end investment company. (1) The fair market value of a share in an open-end investment company (commonly known as a "mutual fund") is the public offering price of a share, adjusted for any reduction in price available to the public in acquiring the number of shares being valued. In the absence of an affirmative showing of the public offering prices in effect at the time of death, the last public offering price quoted by the company for the date of death

paid the assessed deficiency, and then, alleging overpayment of the tax, on December 6, 1967 filed his claim under 28 U.S.C. §§ 1340 and 1346 in the district court for a refund of $3,092.59. In this case the public offering price is the price at which the shares in the mutual funds are marketed and distributed by Investors Diversified Services, Inc. (IDS). IDS is not an open-end investment company but, rather, in addition to its functions of organizing and managing the funds herein involved, it acts in a capacity which is analogous to that of a stockbroker. Shares in the mutual funds organized by IDS are obtained initially by purchase through IDS

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shall be presumed to be the applicable public offering price. If the alternate valuation under section 2032 is elected, the last public offering price quoted by the company for the alternate valuation date shall be the applicable public offering price. If there is no public offering price quoted by the company for the applicable valuation date (e.g., the valuation date is a Saturday, Sunday, or holiday), the fair market value of the mutual fund share is the last public offering price quoted by the company for the first day preceding the applicable valuation date for which there is a quotation, adjusted for any reduction in price available to the public in acquiring the number of shares being valued. In any case where a dividend is declared on a share in an open-end investment company before the decedent's death but payable to shareholders of record on a date after his death and the share is selling "ex-dividend" on the date of the decedent's death, the amount of the dividend is added to the ex-dividend quotation in determining the fair market value of the share as of the date of the decedent's death. As used in this paragraph, the term "open-end investment company" includes only a company which on the applicable valuation date was engaged in offering its shares to the public in the capacity of an open-end investment company.

at a price equal to the net asset value of the shares plus a fee called the sales load or load charge. As found by the court below in 323 F. Supp. at 770-771, the load charge "usually covers the cost of expenses and profit to the broker . . . . [footnote omitted]" The nature of the sales is further clarified by the parties' stipulation of facts for the proceedings below:

> IDS is required by § 22(d) of the Investment Company Act of 1940, 15 U.S.C. § 80a-22, to sell shares in these registered investment companies at the current public offering price described in the prospectus (in this instance net asset value plus a maximum sales charge of 8% of the public offering price). IDS receives, in full payment for its services as distributor of these shares, a distribution fee equal to the amount by which the public offering price exceeds net asset value (a sales charge of a maximum of 8% of the public offering price with lesser percentages applying for quantity sales). The remainder of the purchase price is the "net asset value" which is remitted to the investment company. From its fee, IDS pays commission to its sales representatives and other expenses incident to or in connection with the distribution and sale of the investment companies stock.

The cost the investor paid for the sales load is thereafter lost to him, for the ordinary, and, indeed, the only practical, method of disposing of the shares is through redemption by the company, and shares are redeemed at their net asset value as of the date of redemption.

Appellee disregarded Regulation 20.2031-8(b) and did not include the cost of the sales load as part of the value of his decedent's mutual fund shares, and

thereafter, as stated above, the Commissioner of Internal Revenue assessed a deficiency.

As was observed by the district court at 323 F. Supp. 770:

> If Treasury Regulations 20.2031-8(b) is reasonable, it must be upheld by the court [United States v. Correll, 389 U.S. 299, 306-307, 88 S.Ct. 445, 19 L.Ed. 2d 537 (1967)], even if another method of valuing the shares would conform to the statute [Mearkle's Estate v. Commissioner of Internal Revenue, 129 F.2d 386, 388-389 (3rd Cir. 1942)].

The application of a standard of "reasonableness" to the regulation under consideration has produced varied results. The regulation has been previously considered and held valid in *Ruehlmann* v. *Commissioner of Internal Revenue*, 418 F. 2d 1302 (6 Cir. 1969), *affirming* the Tax Court, 50 T. C. 871 (1968), *cert. denied*, 398 U. S. 950 (1970), *rehearing denied*, 400 U. S. 856 (1970). In *Howell* v' *United States*, 414 F. 2d 45 (7 Cir. 1969), the companion gift tax regulation (Section 25.2512-6(b) (1968)) was held valid. Contrary-wise, in *Davis* v. *United States*, 306 F. Supp. 949 (C. D. Calif. 1969), now on appeal by the Government to the Ninth Circuit (No. 25,736), the district court held that the regulation was unreasonable. Moreover, since Judge Curtin handed down his decision in the instant case, Judge Winner in the United States District Court for the District of Colorado has also ruled in *Hicks* v. *United States*, 335 F. Supp. 474 (1971) that the regulation is unreasonable.

We note that here the Government primarily rests on the same arguments as those it advanced in the

court below. Here, as in the district court, the Government has two main bases for supporting its contention that it is reasonable for estate tax purposes to value mutual fund shares at an amount greater than that which the owner could reasonably expect to receive for them. First, it argues, that, under the circumstances peculiar to mutual fund shares, the challenged regulation is in line with the general principles of valuation set out in Treasury Regulation 20.2031-1(b).[8] Second, the Government seeks to

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[8] Regulation 20.2031-1(b) in pertinent part reads:

> (b) Valuation of property in general. The value of every item of property includible in a decedent's gross estate under sections 2031 through 2044 is its fair market value at the time of the decedent's death, except that if the executor elects the alternate valuation method under section 2032, it is the fair market value thereof at the date, and with the adjustments, prescribed in that section. The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. The fair market value of a particular item of property includible in the decedent's gross estate is not to be determined by a forced sale price. Nor is the fair market value of an item of property to be determined by the sale price of the item in a market other than that in which such item is most commonly sold to the public, taking into account the location of the item wherever appropriate. Thus, in the case of an item of property includible in the decedent's gross estate, which is generally obtained by the public in the retail market, the fair market value of such an item of property is the price at which the item or a comparable item would be sold at retail. For example, the fair market value of an automobile (an article generally obtained by the public in the retail market) includible in the decedent's gross estate is the price for which an automobile of the same or

analogize its method of valuing shares in mutual funds to the method of valuing single premium insurance policies sustained by the Supreme Court in *Guggenheim* v. *Rasquin*, 312 U. S. 254 (1941). These two main lines of the Government's argument were adequately refuted in Judge Curtin's opinion below and we fully concur in his reasoning disposing of them. We will not restate the district court's conclusions found in 323 F. Supp. at 772-773, but instead address ourselves to some of the more peripheral issues the Government raises on appeal.

The Government forcefully contends that mutual fund shares have a value beyond the redemption price and that that value is reasonably measured by the added amount represented by the load charge. We quote from page 17 of its brief: "The estate and the decedent's beneficiaries may continue to own the mutual fund shares, which provide not only the right

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approximately the same description, make, model, age, condition, etc., could be purchased by a member of the general public and not the price for which the particular automobile of the decedent would be purchased by a dealer in used automobiles. Examples of items of property which are generally sold to the public at retail may be found in §§ 20.2031-6 and 20.2031-8. The value is generally to be determined by ascertaining as a basis the fair market value as of the applicable valuation date of each unit of property. For example, in the case of shares of stock or bonds, such unit of property is generally a share of stock or a bond. Livestock, farm machinery, harvested and growing crops must generally be itemized and the value of each item separately returned. Property shall not be returned at the value at which it is assessed for local tax purposes unless that value represents the fair market value as of the applicable valuation date. All relevant facts and elements of value as of the applicable valuation date shall be considered in every case.

to redeem, but also the right to retain the property for its investment features, which include the possibility of capital gains and dividends which may be used to purchase additional shares at less than the public offering price . . . , the diversification of investment for a small outlay, and expert management." This argument applies with equal force to the shares of numbers of corporations listed on the stock exchanges, not only to the mutual fund shares. Clearly, the commissions paid to brokers when shares in these companies are bought or sold are not in payment for, or a measure of, the value beyond the resale price, but are rather simply compensation to the broker for his services. The fallacy in the Government's position was demonstrated by Tax Court Judge Tannenwald when he spoke for the minority of the Tax Court in *Wells* v. *Commissioner*, 50 T. C. 871, 880 (1968).[4] That court by a vote of 7 to 6 held the regulation in issue here to be a reasonable one. Judge Tannenwald stated:

> The emphasis by the majority on the fact that the estate and the beneficiaries may continue to own the mutual fund shares and thereby enjoy the benefits of ownership is, in my opinion, wholly misplaced. These possibilities exist with respect to every type of security. If the majority standard is correct, it would be no less "appropriate" to use replacement cost with respect to marketable securities of all kinds. This, however, is simply not the law. That there may be an equivalence of replacement cost and fair market

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[4] The majority decision was affirmed in *Ruehlmann* v. *Commissioner of Internal Revenue*, 418 F.2d 1302 (6 Cir. 1969), *cert. denied*, 398 U.S. 950 (1970).

value in some situations does not justify the substitution of the former for the latter as the criterion in other situations where different considerations are involved.

The Government suggests that the challenged regulation only applies a general principle of valuation to the valuation of mutual fund shares that a unit of property is worth what a purchaser would have to pay to obtain similar property in the open market, that is, its retail price, and points to Treasury Regulation 20.2031-1(b)[8] as support for the suggestion. However, if there is indeed a widely accepted principle of valuation contained within that recently revised regulation, it is most certainly embodied in the sentence, "All relevant facts and elements of value as of the applicable valuation date shall be considered in every case." We would agree with the *Ruehlmann* case, *supra* at 1034, that the retail sales price of a property unit may be an important factor in the determination of its fair market value; yet it is also clear that other factors can affect the price which a willing seller reasonably could expect to receive from a sale of that particular unit, and if these other factors cause the retail price to be an unreasonable or unrealistic value standard, the retail price has not always been followed in valuation disputes as the sole criterion of value.[9]

---

[8] See Footnote 3.

[9] *Duke* v. *Commissioner of Internal Revenue*, 200 F.2d 82 (1952), cited by the Government, in no way contradicts that principle, for, as was pointed out by Judge Frank in that opinion, in *Duke* there was no evidence of the fair market value of the property in question other than its retail value.

In his dissent in *Wells, supra* at 878, Judge Tannenwald cited two examples of this principle which we find very persuasive. He pointed out that "when the open-market price of bonds is less than par but the bonds can be applied at par in payment of the decedent's estate tax, the par value is includable in the gross estate. *Bankers Trust Co.* v. *United States*, 284 F. 2d 537 (C. A. 2, 1960), *certiorari denied* 366 U.S. 903 (1961); *Candler* v. *United States*, 303 F. 2d 439 (C. A. 5, 1962)." He also found support for the principle in a Treasury Regulation relating to an area which is strikingly similar to that in the present case, a regulation relative to the valuation of shares of corporate stock which are subject to a restrictive agreement that they cannot be sold unless first offered to the corporation itself, or to a third person, at a specified price. If such a restriction upon the transfer of stock is created in an arm's length transaction, Treasury Regulation 20.2031-2(h) (1958) requires that the price so specified be determined to be the fair market value of the shares.[7]

Thus according to generally accepted principles of valuation, the Government's theories of retail value should not be applied in this case. As we have stated, fair market valuation requires that consideration be accorded to all factors affecting the value of the

[7] The district court in the *Davis* case thought that the situations were so similar that similar treatment was required. To quote the court in that case in 306 F. Supp. at 955: "Although there is no binding contract in this case, the rationale of Treas. Reg. 20.2031-2(h) (1958) should apply to the open-end investment shares because the redemption price offered by the company truly represents the only realistic value that the estate can obtain for the shares of the open-end investment company."

property and not the retail sales price alone. Obviously, here, the estate can realistically expect to receive only the net asset value of the shares, not the price the general public would pay for them. We therefore agree with the court below that Treasury Regulation 20.2031-8(b) is an unreasonable regulation.

The lower court judgment for taxpayer is affirmed.

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE
SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the twenty-seventh day of March one thousand nine hundred and seventy-two.

Present:

HON. STERRY R. WATERMAN,
HON. J. JOSEPH SMITH,
HON. WILLIAM H. TIMBERS,
Circuit Judges.

DOUGLAS B. CARTWRIGHT, as Executor of the Estate of ETHEL B. BENNETT, PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

Appeal from the United States District Court for the Western District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Western District of New York, and was argued by counsel.

ON CONSIDERATION WHEREFORE, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed with costs to be taxed against the appellant.

A. DANIEL FUSARO,
Clerk

APPENDIX D

Internal Revenue Code of 1954 (26 U. S. C.):

SEC. 1014. BASIS OF PROPERTY ACQUIRED FROM A DECEDENT.

(a) *In General.*—Except as otherwise provided in this section, the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, be the fair market value of the property at the date of the decedent's death, or, in the case of an election under either section 2032 or section 811(j) of the Internal Revenue Code of 1939 where the decedent died after October 21, 1942, its value at the applicable valuation date prescribed by those sections.

* * * *

SEC. 1015. BASIS OF PROPERTY ACQUIRED BY GIFTS AND TRANSFERS IN TRUST.

(a) *Gifts After December 31, 1920*—If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if such basis (adjusted for the period before the date of the gift as provided in section 1016) is greater than the fair market value of the property at the time of the gift, then for the purpose of determining loss the basis shall be such fair market value. If the facts necessary to determine the basis in the hands of the

donor or the last preceding owner are unknown to the donee, the Secretary or his delegate shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Secretary or his delegate finds it impossible to obtain such facts, the basis in the hands of such donor or last preceding owner shall be the fair market value of such property as found by the Secretary or his delegate as of the date or approximate date at which, according to the best information that the Secretary or his delegate is able to obtain, such property was acquired by such donor or last preceding owner.

* * * * *

SEC. 2031. [as amended by Sec. 18(a), Revenue Act of 1962, P. L. 87-834, 76 Stat. 960]. DEFINITION OF GROSS ESTATE.

(a) *General.*—The value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated.

(b) *Valuation of Unlisted Stock and Securities.*—In the case of stock and securities of a corporation the value of which, by reason of their not being listed on an exchange and by reason of the absence of sales thereof, cannot be determined with reference to bid and asked prices or with reference to sales prices, the value thereof shall be determined by taking into consideration, in addition to all other factors, the value of stock or securities of corporations engaged in the same

or a similar line of business which are listed on the exchange.

SEC. 2033. [As amended by Sec. 18(a), Revenue Act of 1962, *supra*]. PROPERTY IN WHICH THE DECEDENT HAD AN INTEREST.

The value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

Treasury Regulations on Estate Tax (1954 Code) (26 C. F. R.):

§ 20.2031-1 *Definition of gross estates; valuation of property.*

* * * * *

(b) *Valuation of property in general.* The value of every item of property includible in a decedent's gross estate under sections 2031 through 2044 is its fair market value at the time of the decedent's death, except that if the executor elects the alternate valuation method under section 2032, it is the fair market value thereof at the date, and with the adjustments, prescribed in that section. The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. The fair market value of a particular item of property includible in the decedent's gross estate is not to be determined by a forced sale price. Nor is the fair market value of an item of property to be determined by the sale price of the item in a market other

than that in which such item is most commonly sold to the public, taking into account the location of the item wherever appropriate. Thus, in the case of an item of property includible in the decedent's gross estate, which is generally obtained by the public in the retail market, the fair market value of such an item of property is the price at which the item or a comparable item would be sold at retail. For example, the fair market value of an automobile (an article generally obtained by the public in the retail market) includible in the decedent's gross estate is the price for which an automobile of the same or approximately the same description, make model, age, condition, etc., could be purchased by a member of the general public and not the price for which the particular automobile of the decedent would be purchased by a dealer in used automobiles. Examples of items of property which are generally sold to the public at retail may be found in §§ 20.2031-6 and 20.2031-8. The value is generally to be determined by ascertaining as a basis the fair market value as of the applicable valuation date of each unit of property. For example, in the case of shares of stock or bonds, such unit of property is generally a share of stock or a bond. Livestock, farm machinery, harvested and growing crops must generally be itemized and the value of each item separately returned. Property shall not be returned at the value at which it is assessed for local tax purposes unless that value represents the fair market value as of the applicable valuation date. All relevant facts and elements of value as of the applicable valuation date shall

be considered in every case. The value of items of property which were held by the decedent for sale in the course of a business generally should be reflected in the value of the business. For valuation of interests in businesses, see § 20.2031-3. See § 20.2031-2 and §§ 20.2031-4 through 20.-2031-8 for further information concerning the valuation of other particular kinds of property. For certain circumstances under which the sale of an item of property at a price below its fair market value may result in a deduction for the estate, see paragraph (d)(2) of § 20.2053-3.

* * * * *

§ 20.2031-8 *Valuation of certain life insurance and annuity contracts; valuation of shares in an open-end investment company.*

* * * * *

(b) *Valuation of shares in an open-end investment company.* (1) The fair market value of a share in an open-end investment company (commonly known as a "mutual fund") is the public offering price of a share, adjusted for any reduction in price available to the public in acquiring the number of shares being valued. In the absence of an affirmative showing of the public offering price in effect at the time of death, the last public offering price quoted by the company for the date of death shall be presumed to be the applicable public offering price. If the alternate valuation under section 2032 is elected, the last public offering price quoted by the company for the alternate valuation date shall be the applicable public offering

price. If there is no public offering price quoted by the company for the applicable valuation date (e.g.), the valuation date is a Saturday, Sunday, or holiday), the fair market value of the mutual fund share is the last public offering price quoted by the company for the first day preceding the applicable valuation date for which there is a quotation, adjusted for any reduction in price available to the public in acquiring the number of shares being valued. In any case where a dividend is declared on a share in an open-end investment company before the decedent's death but payable to shareholders of record on a date after his death and the share is selling "ex-dividend" on the date of the decedent's death, the amount of the dividend is added to the ex-dividend quotation in determining the fair market value of the share as of the date of the decedent's death. As used in this paragraph, the term "open-end investment company" includes only a company which on the applicable valuation date was engaged in offering its shares to the public in the capacity of an open-end investment company.

(2) The provisions of this paragraph shall apply with respect to estates of decedents dying after October 10, 1963.

Treasury Regulations on Gift Tax (1954 Code) (26 C. F. R.):

SEC. 25.2512-6. Valuation of certain life insurance and annuity contracts; valuation of shares in an open-end investment company.

* * * *

(b) *Valuation of shares in an open-end investment company.* (1) The fair market value of a share in an open-end investment company (commonly known as a "mutual fund") is the public offering price of a share, adjusted for any reduction in price available to the public in acquiring the number of shares included in the particular gift. In the absence of an affirmative showing of the public offering price in effect at the time of the gift, the last public offering price quoted by the company for the date of the gift shall be presumed to be the applicable public offering price. If there is no public offering price quoted by the company for the date of the gift (e.g., the date of the gift is a Saturday, Sunday or holiday), the fair market value of the mutual fund share is the last public offering price quoted by the company for the first day preceding the date of the gift for which there is a quotation, adjusted for any reduction in price available to the public in acquiring the number of shares included in the particular gift. As used in this paragraph, the term "open-end investment company" includes only a company which on the date of the gift was engaged in offering its shares to the public in the capacity of an open-end investment company.

(2) The provisions of this paragraph shall apply with respect to gifts made after October 10, 1963.

(26 C. F. R., Sec. 25.2512-6.)

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IN THE

Supreme Court of the United States

October Term, 1971

No. 71-1665

UNITED STATES OF AMERICA,

Petitioner,

v.

DOUGLAS B. CARTWRIGHT, as Executor of the ESTATE OF ETHEL B. BENNETT,

Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Ralph J. Gregg, on behalf of the Respondent, submits this brief in opposition to a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit in this case.

Questions Presented

The question as stated in the petition (whether the regulation is valid) is not the basic issue. The basic question is the "value" of the mutual fund shares owned by Ethel B. Bennett within the meaning of the word "value" in

§ 2031 of the Internal Revenue Code. The regulation is only the Commissioner's own opinion, understandably biased, of how "value" should be determined under that section. It does not preclude the Court from considering the real issues in dispute, which are:

1. Was the fair market value of the mutual funds owned by Ethel B. Bennett at the time of her death:

(a) The $124,399.87 the executor would have received for them if he had sold them on that date (*i.e.* the bid or redemption price) or

(b) The $133,325.14 the executor would have had to pay to purchase the same number of additional shares on that date (*i.e.* the replacement cost or asked price)?

2. Is the difference (the $8,925.27 that would have to be paid to the broker as a commisison on the purchase of the additional shares) an asset of her estate subject to the estate tax?

Once these questions have been answered, the Court will be in a position to determine if the regulation is a fair and reasonable interpretation of the statute or an arbitrary and unreasonable one.

Statement of the Case

The statement of the case as it appears in the government's petition is a generalization about investment companies. Some of the generalizations are unobjectionable, but some are incomplete, misleading or inaccurate with reference to the particular facts of this case. The correct facts developed both through stipulations, expert testimony and exhibits are these:

1. The statement that "a mutual fund is an organization which sells shares in itself" is not entirely accurate. Only a "no load" fund can be said to sell shares in itself, *i.e.*, it uses no marketing agent or broker to sell its shares to the public. Investors Stock Fund, Inc., Investors Mutual, Inc. and Investors Selective Fund, Inc. are "load" funds. Their shares are distributed by Investors Diversified Services, Inc. (hereinafter referred to as IDS) which is not an investment company, pursuant to a distribution agreement with the investment companies. IDS receives, in full payment for its services as distributor of these shares, a distribution fee equal to the amount by which the public offering price exceeds net asset value. The remainder of the purchase price is the "net asset value" which is received by the investment company. From its fee, IDS pays commissions to its sales representatives and other expenses incident to or in connection with the distribution and sales of shares. IDS also provides investment advisory and management services for its affiliated investment companies. No part of the "load" or "distribution fee" is for investment advisory or management services. Instead, by separate contract, the investment companies pay IDS a management fee out of the income otherwise distributable to the shareholders as dividends.

2. The statement that open-end investment companies are "required by law" to redeem outstanding shares is inaccurate. The proof in this case was that Investors Mutual Funds, Inc., Investors Stock Funds, Inc. and Investors Selective Fund, Inc. were obligated by contract, not by law, to redeem their shares. Before an investment company can register with the Securities and Exchange Commission as either an "open-end" or a "closed-end" investment company (which does not redeem its shares) it must

elect which it chooses to be. This election is made in its certificate of incorporation which must predate the SEC registration. The certificate of incorporation of each of these investment companies gives each registered shareholder the right to require it to redeem its shares at any time at their "net asset value" and without charge. The obligation is contractual. The prospectus of each of these companies correctly states, therefore, that "by express provision in the Company's certificate of incorporation, the registered holder of shares of the company has the right to require the company to redeem his shares". The evidence in this case was that these investment companies consider it advantageous for sound and realistic business reasons to willingly offer and to stand ready, willing and able at all times to redeem any shares presented to them. The promise of immediate and guaranteed liquidity is an extremely important and integral part of the making of a sale. Investment companies compete effectively with securities listed on the exchanges by offering and promising to redeem shares "at the market" and to pay for them in cash upon receipt of the certificate and in no event later than seven days from the receipt of the tender.

3. The explanation of the bid and asked prices would be more understandable if stated as follows:

(a) The public offering price is the "net asset value, ordinarily determined daily, plus a maximum sales charge of 8% of the public offering price" (lesser commission percentages apply for quantity sales). This is generally described as the "asked" price in the financial pages.

(b) The "net asset value" is computed daily as of the close of trading on the New York Stock Exchange when the exact value of the entire portfolio of securities can be accurately determined. The total assets are valued and the

total outstanding liabilities are subtracted. The resulting net worth is divided by the number of outstanding shares to determine the "net asset value" per share. This is generally described as the "bid" price in the financial pages.

(c) The difference between the bid and asked prices quoted daily in the paper is the commission or "load" that the purchaser must pay to the broker to acquire shares having a net asset value equal to the bid price. If a mutual fund company decides to market its own shares without a sales charge, *i.e.* if a "load" fund becomes a "no load" fund, the value of the shares is then publicly quoted at net asset value in both columns for the purpose of both sale and redemption.

4. The statement in the petition that "in the normal course of business, all transactions for purchase or sale of shares of open-end investment companies, including the three herein, take place between the investor and the issuing company whose shares are involved" is misleading. Load funds market their shares through brokers, securities dealers, underwriters or other distributing or marketing agents. The distributor of the shares involved here is Investors Diversified Services, Inc. Investors Mutual, Inc. Investors Stock Funds, Inc. and Investors Selective Fund, Inc. pay no part of the brokers' commissions. To do so would dilute the fund belonging to the shareholders. The entire commission is paid by the purchaser. These mutual fund companies receive only the net asset value. To receive more would unduly enrich previous shareholders. By agreement with its marketing agent, shareholders are permitted to reinvest their income and capital gains distributions in additional shares at their net asset value and without any commission or load to IDS.

5. It is not correct that the maximum sales load of the funds "involved here" ranged between 7% and 8% and a minimum of 1%. The holdings of Ethel B. Bennett in each of the three funds were, in dollar amounts, too small to qualify for quantity discounts lower than 6%.

6. The government's statement omits the fact that although there are no restrictions on the transferability of shares of these investment companies, the shareholders dispose of them by requesting the company to redeem them, there being no other market for these shares. The redemption price is the "net asset value" calculated as of the close of business on the day of receipt of the surrendered stock certificates or (if the shares are held by the investment company for the account of the owner) on receipt of the request to redeem. There is no charge for redemption.

7. The government's statement of facts omits any reference to additional facts which are distinctive to this case and which are relevant to the issues, as follows:

(a) Ethel B. Bennett acquired none of her shares by purchase at the "asked" price. She acquired most of them from the estate of her husband, Arthur Y. Bennett, who died on October 1, 1962. These shares were valued in his estate at their net asset value or redemption price and this valuation was accepted on the audit of his estate tax return. She acquired the rest by reinvesting her dividends and capital gains distributions in additional shares at their "net asset value" or bid price.[1]

(b) The beneficiaries of the Estate of Ethel B. Bennett have sold some of the shares she owned and realized only their net asset value, as follows:

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[1] The right to reinvest dividends and capital gains is extended to any shareholder whether he paid the asked price or not.

(i) All 2,568.422 shares of Investors Mutual, Inc. were distributed to Douglas B. Cartwright and Carolyn Tenney as trustees for the benefit of Dorothy B. Cartwright. The trustees tendered these shares for redemption on February 19, 1969, and received payment for them at their "net asset value" or bid price.

(ii) 969.376 out of 2269.376 shares of Investors Stock Fund, Inc. were distributed to the same trustees who also tendered them for redemption on February 19, 1969, and received payment for them at their "net asset value" or bid price.

(iii) The remaining 1260 shares of Investors Stock Fund, Inc. were distributed outright to Dorothy B. Cartwright. She gave 430 of them to Douglas B. Cartwright. He requested Investors Stock Fund, Inc. to redeem his 430 shares on November 7, 1966, and they were redeemed at their "net asset value" or bid price.

As of the date of the trial, Mrs. Bennett's heirs still owned 860 shares of Investors Stock Fund, Inc., 1,869.159 shares of Investors Selective Fund, Inc. and 2,067.531 shares of Investors Mutual, Inc.

Reasons for Denying the Writ

Many millions of mutual fund shares have been valued for estate tax purposes since the enactment of the Investment Companies Act in 1940.

For upwards of 20 years until about 1961, the Internal Revenue Service accepted their valuation at net asset value or bid price (the price at which the investment companies contractually agree to redeem them whenever offered for redemption).

This was completely consistent with long accepted concepts of valuation for estate tax purposes, *i.e.*, that the estate tax was to be imposed on the amount the estate could reasonably be expected to realize from the decedent's property. Witness the "blockage" rule, the acceptance of the contract price specified in arms-length corporate buy-sell agreements as determinative of value to the estate, the valuation of an automobile at what the widow could reasonably expect to sell it for, the valuation of furniture and household goods at prices an auctioneer, antique dealer or other qualified appraiser believed the estate could realize from their sale, etc.

But, in about 1961, the Treasury Department conceived the idea of increasing the revenue significantly by valuing mutual fund shares at the asked price (the price the executor would have to pay to purchase as many additional shares as the estate already owned).

The difference between the bid and asked prices quoted in the papers is the commission that goes to the broker for bringing the seller and the buyer together. This sales charge, commonly referred to as a "load", is exactly like the commission charged by Merrill, Lynch or Goodbody & Co. for handling the purchase of shares of General Motors. It is not an element of value—and is not included in the published price of General Motors stock.

The Treasury has always agreed that the broker's commission on the purchase of listed and over-the-counter securities has absolutely no bearing on the value of the listed stocks owned by the estate. Nevertheless, it began to insist on including the broker's commissions in the value of mutual fund shares.

Hundreds and perhaps thousands of protests were registered in District and Regional offices and some of them reached the litigation stages in both the Tax Court and as claims for refund in the District Courts where, by law, the Department of Justice represents the Treasury.

The Department of Justice reacted by ordering the Internal Revenue Service to make refunds to the executors,[2] agreeing that the fair market value for estate tax purposes was the amount the executors could get for the shares and not what they would have to pay to purchase as many more through a broker.

The Treasury Department reacted in turn by issuing Reg. Sec. 20.2031-8 (b) on October 11, 1963, to substitute a new issue for taxpayers to overcome, *i. e.*, the burden of proving that the Commissioner was completely unreasonable, arbitrary and capricious in the exercise of his power to issue regulations.

The new rule would have stuck out like a sore thumb in the regulations dealing with the valuation of stocks and bonds (20.2031-2 (a)-(h)). So the Commissioner inserted it in the regulation dealing with the valuation of single premium life insurance policies (20.2031-8) at so-called replacement cost for whatever mileage this would give him on the issue of reasonableness. It was a clever maneuver because it pushed the valuation issue, on which the taxpayer was clearly right, into the background.

Then, to be sure no court would rule in favor of a taxpayer on the valuation issue before it could use its "power to make regulations which the courts must uphold unless

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[2] *Estate of Addie G. Baldwin v. United States,* USDC, WDNY (1/14/63); *Estate of Ethel Louise Stern v. United States,* USDC, WDNY ((5/28/63).

completely unreasonable" issue, the Treasury issued Rev. Proc. 64-18, 1964-1 CB (Part 1) 681, instructing all personnel to refund any taxes collected on the sales charge or "load" in estates of persons dying before October 11, 1963, thereby clearing all the dockets in the Tax Court and the District Courts.

This maneuver enabled the Treasury Department to select a case involving a decedent dying after October 11, 1963, and to have Treasury Department attorneys use the regulation as the decisive issue in the Tax Court (*Wells v. Commissioner,* 50 TC 871, where the Court held, in substance, that the taxpayer had not carried his burden of proving that the Commissioner was completely unreasonable, arbitrary and capricious).

Since the Department of Justice is obliged by statute to represent the Treasury in the Federal Courts, it thus became obliged to defend a theory of valuation it had previously opposed. It succeeded in getting the Sixth Circuit Court of Appeals to affirm the *Wells* case in *Ruehlmann v. Commissioner,* 418 F. 2d 1302 (1969), the rationale of which was copied by the Seventh Circuit Court of Appeals in a gift tax case, *Howell v. United States,* 414 F. 2d 45 (1969).

The *Wells* case shocked the financial community which knows that the 8% sales charge or "load" goes to the marketing agent and that the moment the purchase price is paid, all the owner, alive or dead, can get from anybody for his shares, is the net asset value. It dumbfounded the investment companies whose sales literature, governed by SEC regulations, makes a special point of the fact that for every $10,000.00 invested with them, the purchaser will have shares worth $9,200.00. It made brokers

and investors alike (and businessmen generally) wonder how the Courts could be so oblivious to the business facts.

Intrigued with the revenue producing potential of the so-called "replacement cost" theory, the Commissioner, on June 7, 1965, amended Reg. Sec. 20.2031-1 (b) to add a new concept of valuation for automobiles, household furniture and furnishings, personal effects and property generally. Gone was the idea that the fair market value of the decedent's 1970 Electra is the $3,000.00 the widow could get for her deceased husband's car from a willing buyer. In its place was the newer concept that the value of the decedent's 1970 Electra is the $3,600.00 retail price the widow would have to pay to purchase somebody else's reconditioned, warranteed 1970 Electra from a retail dealer.[8]

The Internal Revenue Service has not risked a lawsuit as to the validity of this regulation, apparently preferring to first "nail down" its new replacement cost theory with the more sophisticated arguments it can use to cloud the issues in the mutual fund litigation.

None of these regulations were "needful" after upwards of 40 years of undisputed acceptance of the Commissioner's method of determining the value of automobiles, boats, pianos, silverware, jewelry, etc. for estate tax purposes under Reg. Sec. 20.2031-6 and over 20 years of non-controversial valuation of mutual funds under Reg. Sec. 20.2031-2.

The Commissioner's new regulations were clearly intended to legislate the method which would produce the

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[8] See example used by the Commissioner in his regulation to illustrate his new "retail price" theory of valuing an auto; and how he attempts to tie it to the coattails of the "replacement cost" theory of Reg. Sec. 20.2031-8.

greatest revenue without regard to well established concepts of fair market value.

The mutual fund regulation was not the product of a considered judgment. It was an arbitrary expedient to put the entire weight of the government on the taxpayer; to multiply his burden of proof and to halve his chances of getting judicial relief, knowing full well that millions of small taxpayers would have to "knuckle under" because they could not afford to litigate the issue. This approach to the collection of revenues does little to enhance the esteem of the government in the eyes of the taxpayer.

The amount involved here is only $2,699.41. The decision in favor of the taxpayer in the District Court was obviously correct, well reasoned and consistent with the estate tax statutes enacted by Congress. Nevertheless, the government dragged this taxpayer to a Circuit Court of Appeals which, again, confirmed his right to a refund.

The decision in favor of the taxpayer in *Robert C. Davis v. United States*, 306 F. Supp. 949, affirmed in the Ninth Circuit on May 23, 1972 (and involving a refund claim of $604.84) contains equally convincing reasons why the Treasury is wrong and should abandon its unreasonable position and withdraw its regulations.

Nevertheless, the government proposes to make this taxpayer defend his rights in the Supreme Court of the United States when it is abundantly clear that the Commissioner should have sought the approval of Congress for such revolutionary changes in the estate tax laws and should now correct his own error without further harassment of taxpayers on the transparent pretext that mutual fund shares are the closest of kin to single premium life insurance policies and diamond rings subject to wartime luxury excise taxes.

Apropos of the situation here is the commentary of Mr. Justice Douglas in *Commissioner v. Lester*, 366 U. S. 299, 311, 312:

> "The revenue laws have become so complicated and intricate that I think the government in moving against this citizen should also turn square corners . . . resort to litigation, rather than to Congress for a change in the law is too often the temptation of government which has a longer purse and more endurance than any taxpayer."

Certiorari should be denied.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1972

No. 71-1665

UNITED STATES OF AMERICA, PETITIONER

v.

DOUGLAS B. CARTWRIGHT, AS EXECUTOR OF THE ESTATE OF ETHEL B. BENNETT

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the district court (Pet. 12-22 [1]) is reported at 323 F. Supp. 769. The opinion of the court of appeals (Pet. 23-33) is reported at 457 F. 2d 567.

JURISDICTION

The judgment of the court of appeals was entered on March 27, 1972. (Pet. 34.) The petition for certiorari was filed on June 22, 1972, and certiorari was

[1] "Pet." references are to the petition for certiorari.

granted on October 10, 1972. (App. 87.[1]) The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether Section 20.2031–8(b) of the Treasury Regulations on Estate Tax, which provides that shares in mutual funds are valued for estate tax purposes at the public offering (asked) price, rather than the redemption (bid) price, is valid.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the Internal Revenue Code of 1954 and of the Treasury Regulations on Estate Tax (1954 Code) are set forth in the Appendix, *infra*, pp. 23–27.

STATEMENT

At the time of her death on December 4, 1964, the decedent, Ethel B. Bennett, owned shares in three open-end investment companies (mutual funds)[2] registered with and subject to the regulations of the Securities and Exchange Commission. Sections 1 through 53 of the Investment Company Act of 1940, c. 686, 54 Stat. 789 (15 U.S.C. 80a–1 through 80a–52). An open-end mutual fund is an organization which continually sells as many of its shares as can be marketed and, as it is required to do by law, con-

[1] "App." references are to the separately bound record appendix.

[2] Decedent owned in her individual name 2568.422 shares of Investors Mutual, Inc., 2269.876 shares of Investors Stock Fund, Inc., and 1860.150 shares of Investors Selective Fund, Inc. She also held in her name as trustee for her daughter 2067.531 shares of Investors Mutual. (Pet. 12.)

tinually offers to redeem its outstanding shares.[4] With the proceeds from the sale of its shares, the fund invests and trades in securities. (App. 24–25, 50.)

The price at which shares in open-end investment companies (mutual funds) are offered to the public (the "asked" price) is the net asset value, which is the fractional value per share of the fund's net assets, plus a sales load or sales charge. The sales load is a varying percentage of the offering price, dependent upon the quantity of shares purchased in a single transaction.[5] The maximum sales load of the funds held by decedent ranged between seven and eight percent and the minimum was one percent. The price at which mutual funds redeem their shares (the "bid" price) is the net asset value. There is no redemption

[4] During their respective fiscal years ending in 1965, Investors Stock Fund, Inc., issued 15,213,211 shares and redeemed 3,936,997 shares; Investors Mutual, Inc., issued 34,409,678 shares and redeemed 9,107,757 shares; and Investors Selective Fund, Inc., issued 1,517,082 shares and redeemed 1,242,746 shares. (Pltf. Ex. 11.)

[5] Shareholders may purchase additional shares with their dividends and capital gains distributions at the redemption or bid price (net asset value). In addition, no sales load is charged if shareholders wish to exchange their shares in one fund for shares in another fund managed by Investors Diversified Services, Inc. (see *infra*, p. 16). (App. 26.)

There are also no-load open-end investment companies. The no-load funds may charge up to a two percent premium over the net asset value at the time of issuance of a security or at the time of redemption. But a no-load fund may not charge selling commissions at the time of issuance. See Section 10(d), Investment Company Act of 1940, *supra* (15 U.S.C. 80a–10(d)). The two percent premium is not included in the daily asked and bid prices.

charge. Though shares in mutual funds are freely transferable, they are not sold in the securities market. Purchases of mutual fund shares, including shares in the three funds held by the decedent here, ordinarily take place between the investor and the issuing company or its distributor, and the only practical method of disposition is redemption. (Pet. 15–16, 24–26; Pltf. Exs. 3 (p. 14), 4 (p. 13), and 6 (p. 16).)

The three funds involved here were organized and are managed by Investors Diversified Services, Inc. ("IDS"), which is not an open-end investment company itself, but which acts as underwriter, distributor, and manager for the funds. (Pet. 13.) IDS received, in full payment for its services as distributor of shares of these funds, a distribution fee equal to the amount of the sales charge. The remainder of the amount paid by the purchaser of the shares (net asset value) was remitted to the investment company. (Pet. 26.)

On the decedent's federal estate tax return, the respondent-executor valued the shares of the three funds at their redemption price on the date of the decedent's death. In accordance with Section 20.2031-8(b) of the Treasury Regulations on Estate Tax, the Commissioner determined that these shares should be valued at their public offering price on the date of the decedent's death, and accordingly asserted an estate tax deficiency. After paying the tax, the respondent filed a suit for refund on the ground that Section 20.2031-8(b) is invalid. The district court agreed with the respondent and held the regulation invalid. (Pet. 13–14, 22.) The court of appeals affirmed. (Pet. 23–24.)

SUMMARY OF ARGUMENT

Section 2031 of the Internal Revenue Code of 1954, Appendix, *infra*, p. 23, provides that the value of a decedent's gross estate "shall be determined by including * * * the value at the time of * * * death of all property * * *." Section 20.2031-8(b) of the Treasury Regulations on Estate Tax, Appendix, *infra*, pp. 25-26, provides that for estate tax purposes, the "value" of a share in an open-end mutual fund is the public offering ("asked") price of the share. The sole question before the Court in this case is the validity of this regulation. If the regulation is reasonable and consistent with the statute, it must be sustained even though the Commissioner might have taken alternative approaches to valuing mutual fund shares. *United States* v. *Correll*, 389 U.S. 299, 306-307.

The general principle of valuation which the Commissioner applies for estate tax purposes is that the value of an item is its "fair market value," which is the "price at which the property would change hands between a willing buyer and a willing seller * * *." Section 20.2031-1(b) of the Treasury Regulations on Estate Tax (1954 Code), Appendix, *infra*, pp. 24-25. The regulation at issue here, which values mutual funds at the "asked" price, or the price which a member of the public must pay to acquire a share in the mutual fund market, is an application of this general principle of valuation. This Court has long accepted the Commissioner's concept of value in analogous situations. Thus, in *Guggenheim* v. *Rasquin*, 312 U.S. 254, the Court held that the replacement cost of single-premium life insurance

policies, rather than the substantially lower cash surrender value, determined the value of those policies.

In applying the willing buyer-willing seller rule it has long been the practice to include in the value of various items costs such as selling commissions which are included in the retail price quoted to the public. For example, the value of jewelry has been held to be its replacement cost, including the federal excise tax which the dealer passes on to the purchaser, even though these costs might not be recovered if the purchaser should sell the item. Similarly, the willing buyer-willing seller rule precludes the deduction of selling costs and commissions from the valuation of assets, such as real estate and stocks, whose sale is likely to necessitate the payment of commissions.

The Sixth and Seventh Circuits and the Tax Court have held the regulation at issue valid, while the court of appeals below and the Ninth Circuit have held the regulation invalid. The courts which have held the regulation invalid appear to have based their holding largely on the theory that it creates a hardship to value mutual fund shares at an amount in excess of what the estate could obtain if it chose to sell the shares. This argument ignores the fact that if the estate and the beneficiaries continue to hold the mutual fund shares, they enjoy valuable advantages not available if the shares are redeemed, such as the right to use capital gains and dividends to purchase additional shares at net asset value and the right to exchange the shares in one fund for shares in another fund without paying the load. It also ignores the tax consequences

which occur if the estate or the beneficiaries sell the shares. In the former case, the estate ordinarily receives an administrative expense deduction for the difference between the bid and asked prices. Section 20.2053-3(d)(2) of the Treasury Regulations on Estate Tax (1954 Code). In the latter case, the difference constitutes a loss for income tax purposes. Section 1.1014-1, Treasury Regulations on Income Tax (1954 Code).

The court below appears to have concluded that the Commissioner's method of valuing mutual fund shares is inconsistent with the method used for valuing certain other types of securities, including common stocks, government bonds, and restricted stock. (Pet. 30-32.) Analysis of the provisions governing the valuation of each of these securities, however, shows either that the valuation methods used in those situations reflect precisely the same willing buyer-willing seller concept used to value mutual funds, or that peculiar features of these securities require in some circumstances and adjustment of the usual formula.

ARGUMENT

SECTION 20.2031-8(B) OF THE TREASURY REGULATIONS ON ESTATE TAX (1954 CODE), WHICH REQUIRES SHARES OF MUTUAL FUNDS TO BE VALUED FOR ESTATE TAX PURPOSES AT THEIR PUBLIC OFFERING OR ASKED PRICE, IS A REASONABLE IMPLEMENTATION OF SECTION 2031 OF THE INTERNAL REVENUE CODE OF 1954

Section 2031 of the Internal Revenue Code of 1954, Appendix, *infra*, p. 23, provides that the value of a decedent's gross estate "shall be determined by in-

cluding to the extent provided for in this part, the value at the time of * * * death of all property * * *." Section 2033 of the Code, Appendix, *infra*, p. 23, provides for inclusion of "the value of all property to the extent of the interest therein of the decedent at the time of his death." Under his authority to "prescribe all needful rules and regulations for the enforcement of this title" (Section 7805(a) of the Internal Revenue Code of 1954 (26 U.S.C.)), the Commissioner in 1963 promulgated Section 20.2031–8(b) of the Treasury Regulations on Estate Tax (1954 Code), Appendix, *infra*, pp. 25–26, which provides that for estate tax purposes the value of a share in an open-end investment company (mutual fund) is the public offering (asked) price of a share.[6]

The sole question before this Court is the validity of this regulation. If the challenged regulation is reasonable and consistent with the statute, it must be sustained. *Commissioner* v. *South Texas Co.*, 333 U.S. 496, 501. It may be that the Commissioner could have taken a different approach to determining "value" of mutual fund shares within the meaning of Section 2031. The Regulations might, for example, have based value exclusively upon the amount which the estate would realize upon liquidation of the shares, or upon the mean between the bid and asked prices, rather

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[6] A corresponding regulation was promulgated with respect to inter vivos gifts. See Section 25.2512–6(b) of the Treasury Regulations on Gift Tax (1954 Code), Appendix, *infra*, p. 27, which provides that for gift tax purposes the fair market value of a share in an open-end investment company is the public offering (asked) price.

than upon the amount which a member of the public must pay in order to purchase the shares. A Treasury Regulation is not invalid, however, merely because there is an alternative method of implementing the statute. As this Court stated in *United States* v. *Correll,* 389 U.S. 299, 306–307, and reiterated in *Bingler* v. *Johnson,* 394 U.S. 741, 750–751:

> Alternatives * * * are of course available. Improvements might be imagined. But we do not sit as a committee of revision to perfect the administration of the tax laws. Congress has delegated to the Commissioner, not to the courts, the task of prescribing "all needful rules and regulations for the enforcement" of the Internal Revenue Code. 26 U.S.C. § 7805(a). In this area of limitless factual variations, "it is the province of Congress and the Commissioner, not the courts, to make the appropriate adjustments." *Commissioner* v. *Stidger,* 386 U.S. 287, 296. The role of the judiciary in cases of this sort begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the congressional mandate in some reasonable manner.

See also *Ruehlmann* v. *Commissioner,* 418 F. 2d 1302 (C.A. 6), affirming 50 T.C. 871, certiorari denied, 398 U.S. 950, rehearing denied, 400 U.S. 856; *DuPont's Estate* v. *Commissioner,* 233 F. 2d 210 (C.A. 3), certiorari denied, 352 U.S. 878; *Mearkle's Estate* v. *Commissioner,* 129 F. 2d 386 (C.A. 3).

We submit that Section 20.2031–8(b) of the Regulations reasonably implements the Congressional mandate that the "value" of a decedent's assets must be

included in the decedent's gross estate. Indeed, the judgment which this regulation embodies with respect to the appropriate method of valuing mutual fund shares is consistent with the concept of value that the Treasury generally applies in the estate tax context. This basic principle of valuation is set forth in Section 20.2031-1(b) of the Treasury Regulations on Estate Tax (1954 Code), Appendix, *infra*, pp. 24-25, which provides that the value of an item includible in a decedent's gross estate is the "fair market value" of that item on the date of the decedent's death or on the alternative date prescribed by Section 2032 of the Internal Revenue Code of 1954 (26 U.S.C.). Fair market value is defined as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts."[7] As the regulation specifies, where an item is generally obtained by the public at retail, the fair market value is the retail price.

The underlying assumption of the "willing buyer-willing seller" rule is that the most realistic and appropriate value to place upon assets is the amount that the general public is willing to pay for them in the market where they are commonly sold. Since the shares of mutual funds are not sold in the securities

[7] The current version of Section 20.2031-1(b) was promulgated on June 14, 1965, by T.D. 6826, 1965-2 Cum. Bull. 367.

market and are obtainable only from the issuing company or its distributor, Section 20.2031-8(b) of the Regulations appropriately provides that mutual fund shares be valued at the "asked" price, *i.e.*, the price which a willing buyer would pay to acquire shares from the fund. Thus, Section 20.2031-8(b) is an application of the general principle set forth in Section 20.2031-1(b) and is analogous to the example stated in the regulation of the value of an automobile, which is the price at which the automobile could be purchased at retail by a member of the general public, not the lower price at which the automobile might be sold back to a dealer. See *Ruehlmann* v. *Commissioner*, *supra*, 418 F. 2d, p. 1304.[8]

[8] The shares at issue here are analogous in many respects to a new issuance of stock offered to the public through a broker-underwriter, where the issuing corporation receives the amount paid by the purchaser less the underwriting costs. The underwriting costs are generally reflected in the public offering price of original issues, even though the issuing corporation does not receive this portion of the price. If the shares of a new issue are required to be valued for tax purposes before a trading market for the securities has been established, see *infra*, pp. 14, 18-19, it could hardly be argued that underwriting fees which are included in the public offering price should be eliminated in determining the fair market value of the securities. (App. 67-69.) See Securities Act of 1933, c. 38, Title I, 48 Stat. 74, as amended, Sections 7, 10 and Schedule A(5) and (15)-(17) (15 U.S.C. 77g, 77j and 77aa(5) and (15)-(17)); Donaldson and Pfahl, *Corporate Finance* (2d ed., 1963), pp. 317-318; Dewing, *Financial Policy of Corporations* (5th ed., 1953), pp. 1100, 1128-1129; Husband and Dockery, *Modern Corporation Finance* (5th ed., 1962), pp. 342-343.

Although the regulation at issue here was promulgated on October 10, 1963,[8] this Court has long accepted the essential concept of value reflected in the regulation and has consistently applied it in analogous situations. In *Guggenheim* v. *Rasquin*, 312 U.S. 254, *Powers* v. *Commissioner*, 312 U.S. 259, and *United States* v. *Ryerson*, 312 U.S. 260, the Court held that the replacement cost of single-premium life insurance policies, rather than the substantially lower cash surrender value, determined the value of those policies for federal gift tax purposes. The Court rejected in these cases substantially the same argument advanced by the respondent here and accepted by the courts below, that the value of the property was necessarily what the donor could receive through redemption on

[8] T.D. 6680, 1963-2 Cum. Bull. 417. The district court below observed (Pet. 16, 21–22) that the Treasury did not issue this regulation until 1963, and that the various district directors did not follow a consistent position prior to the issuance of the regulation. These considerations present no adequate basis, however, for challenging the validity of the regulation, which was given prospective application only. In *Helvering* v. *Wilshire Oil Co.*, 308 U.S. 90, 103, this Court noted that the Commissioner's rule-making power is especially broad where the effect of the rule promulgated is prospective only. The fact that the Commissioner had previously entered into administrative settlements along the lines of the position asserted by the taxpayer in this case is irrelevant, for administrative settlements are not authoritative precedents (*Freeport Country Club* v. *United States*, 430 F. 2d 986, 993 (C.A. 7)) and are not binding on the Commissioner in other cases (*Lincoln Savings and Loan Assn.* v. *Commissioner*, 51 T.C. 82, 107–108, reversed by court of appeals, 422 F. 2d 90 (C.A. 9), but affirmed by this court, 403 U.S. 345). See also *Dixon* v. *United States*, 381 U.S. 68, 72–73.

the date of the gift. Though these cases involved gift tax, the Court has held that in the absence of express Congressional intent to the contrary, the gift and estate tax laws are to be construed *in pari materia*. *Merrill* v. *Fahs*, 324 U.S. 308, 311–313.

Indeed, it has long been the practice in applying the willing buyer-willing seller rule to include marketing costs, mark-ups, and selling commissions in the value of various items for gift and estate tax purposes, where these commissions and taxes are included in the price quoted to the public. Lowndes and Kramer, *Federal Estate and Gift Taxes* (2d ed.), pp. 441, 465–466. In *Estate of Gould* v. *Commissioner*, 14 T.C. 414, taxpayer purchased a ring at retail and gave it to his wife. The Tax Court, citing *Guggenheim* v. *Rasquin, supra*, held that the value of the ring for gift tax purposes was the replacement cost, including the federal excise tax which the dealer passed on to the purchaser. The court reasoned that the situation was the same as if the taxpayer had given his wife the money to purchase the ring and she had done so. The same result was reached in *Publicker* v. *Commissioner*, 206 F. 2d 250 (C.A. 3), certiorari denied, 346 U.S. 924; and *Duke* v. *Commissioner*, 200 F. 2d 82 (C.A. 2), certiorari denied, 345 U.S. 906, both of which also involved the valuation of jewelry.[10] By analogy, if the

[10] The court of appeals below undertook to distinguish the *Duke* case on the ground that in *Duke* there was no evidence of the fair market value of the property other than its retail value. (Pet. 31.) In this respect, the court appears to have

decedent here had bequeathed cash to be used for the purchase of mutual fund shares, she would have had to bequeath sufficient funds to pay for the "load".

Similarly, the willing buyer-willing seller rule precludes the deduction of selling costs and commissions from the valuation of assets whose sale is likely to necessitate the payment of commissions, and hence the valuation is not the amount which the seller could realize on the sale of the property. If, for example, an estate includes Blackacre, which is valued at $100,000, the estate is charged with the full $100,000 value, not $94,000, even though it is highly likely that the estate or its beneficiaries will pay a $6,000 selling commission upon sale of the property. Lowndes and Kramer, *supra*, p. 441. As in our case, the value for estate tax purposes is the amount which a willing purchaser would pay for the asset, not the amount which the estate or its beneficiaries would realize upon sale. The commissions paid to brokers on sale of stocks are ordinarily treated in the same manner. Consequently, the estate is required to include the full value of shares even though if the stock is sold the seller will realize only the quoted market price of the shares minus the brokerage commission. Of course, if the estate sells the shares, it will ordinarily receive an administrative

questioned the basic assumption embodied in Section 20.2031-1(b) that retail value is generally the appropriate measure of value for tax purposes. It is the price which a willing buyer is willing to pay to a willing seller for the purchased item.

expense deduction for the selling costs. See *infra*, pp. 17–18.

Though other valuation methods might have been reasonably chosen, we submit that the Treasury's decision to value mutual fund shares at the asked price, the price which a willing-buyer member of the general public pays for them, is reasonable and in accordance with the statute. The regulation was held valid by both the Tax Court and the Sixth Circuit in *Ruehlmann* v. *Commissioner, supra*. And the companion gift tax regulation (see footnote 6) was held valid by the Seventh Circuit in *Howell* v. *United States*, 414 F. 2d 45. On the other hand, the Second Circuit in the instant case, and the Ninth Circuit by a divided court in *Davis* v. *United States*, 460 F. 2d 769,[11] have held the regulation invalid.[12]

The courts below appear to have based their conclusion that this regulation is unreasonable largely on

[11] The Government did not seek certiorari in *Davis* because the amount involved in that case was small (approximately $800) and because the issue is adequately presented in the instant case.

[12] In addition to the cases cited above, the regulation was approved in *Estate of York* v. *Commissioner*, 28 T.C.M. 1271, and *Norton* v. *United States*, 70–1 U.S.T.C., par. 12,684 (W.D. Wash.). Neither of those cases was appealed. The regulation was disapproved in *Hicks* v. *United States*, 335 F. Supp. 474 (D. Colo.), where no appeal was taken by the United States because of the dismissal of the taxpayer's complaint on other grounds. *Hicks* is before the Tenth Circuit (No. 72–1360) on taxpayer's appeal. The issue is also pending before the Court of Claims in *Lyons* v. *United States*, No. 354–70.

the ground that it creates a hardship to value mutual fund shares at an amount in excess of what the estate could obtain if it chose to sell them. See, *e.g.*, Pet. 19, 33. Though this argument may appear at first glance to have some appeal, it ignores both the economic reality of mutual fund ownership and the tax consequences which occur upon sale of the shares. To begin with, if the estate and the beneficiaries continue to hold the mutual fund shares, they enjoy several valuable advantages not available if the shares are redeemed. These include the right to use capital gains and dividends to purchase additional shares at net asset value and (in the case of funds distributed by IDS), the right to exchange the shares in one fund for shares in another fund without paying the load. See *supra*, note 5. In this regard the shares are analogous to the insurance policies which the Court dealt with in the *Guggenheim* case, in which the Court noted that certain special features, such as the right to receive the face amount of the policy at death, gave those assets an inherent value greater than the cash surrender value. Although the courts below attempted to distinguish the instant case from *Guggenheim* on the basis of the special privileges attached to the insurance policies at issue in *Guggenheim*, the distinction, if any, is one of degree; though the bundle of rights constituting ownership of a life insurance policy does differ to some extent from the rights in a

mutual fund share, each offers advantages to the holder that are destroyed by redemption.[18]

Analysis of the tax consequences of selling or redeeming the shares at issue here also undercuts the notion that it is unreasonable to value these assets at an amount greater than the estate could realize upon redemption. If the executor of the estate redeemed the mutual fund shares, it would be rare that the net amount subject to tax would be more than the bid price, because Section 20.2053-3(d)(2) of the Treasury Regu-

[18] In any event, the reliance which the courts below placed on the alleged distinction between this case and *Guggenheim* shows that the courts below failed to recognize the basis of that decision. The Court in *Guggenheim* did not question the willing buyer-willing seller rule then set forth in Treasury Regulations 79, Art. 19(1), nor did it question the theory that replacement cost is ordinarily the appropriate value to place upon property for tax purposes. The Court referred to the added value inherent in the special features of the single-premium insurance policies not in order to restrict application of the Commissioner's approach to situations in which property has significant value beyond its cash redemption value, but, rather, in response to taxpayer's argument that "the market for insurance contracts is usually the issuing companies or the banks who will lend money on them" and that "banks will not loan more than the cash-surrender value." The Court enumerated the other features of the policy in order to illustrate that "[a]ll of the economic benefits of a policy must be taken into consideration in determining its value * * *" (312 U.S. at 256-257), concluding that "the value of these policies at the date of the gift was the amount which the insured had expended to acquire them. Cost is cogent evidence of value" (312 U.S. at 257-258).

lations on Estate Tax (1954 Code) (26 C.F.R.) allows a deduction as an administration expense for the difference between the redemption price and the public offering price if the shares are sold in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution. If the shares are acquired by a beneficiary from the estate and sold by him at a price below the estate-tax valuation, the ensuing difference would constitute a loss for income tax purposes. Sections 1001 and 1002, Internal Revenue Code of 1954 (26 U.S.C.); Section 1.1014-1, Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.); *Levin* v. *United States*, 373 F. 2d 434 (C.A. 1). In view of these provisions, there is little basis for respondent's contention below that the regulation in question causes hardship to the owners of mutual funds.

In support of the result which it reached, the court below reasoned that the method of valuing mutual fund shares is inconsistent with the method used for valuing certain other types of securities. (Pet. 30-31.) For example, under Section 20.2031-2 of the Treasury Regulations on Estate Tax, listed stocks are valued at the mean between the highest and lowest quotations on the date of death less any adjustment for a large block of stock whose sale would affect the market price. But Section 20.2031-2 is entirely consistent with the regulation under attack here, because the quoted price of a listed stock, like the asked price of a mutual fund, is the amount which a willing buyer pays to a willing seller. Since the price of a listed

stock fluctuates in the course of a trading day on the stock exchange, it was necessary for the Regulations to designate which quotation on the statutory date of valuation would be used for tax purposes. The mean between the highest and lowest selling price on that date was considered a fair and convenient choice.[14]

The court of appeals also found (Pet. 32-33) an inconsistency between the valuation of mutual fund shares at the asked price and the treatment of certain government bonds, which are available for the payment of estate tax at par even if they are selling in the market at a lower price. Such bonds are valued at par for estate tax purposes. See *Candler* v. *United*

[14] Nor is the regulation at issue here inconsistent with the method of valuing shares in unlisted stocks which are traded over the counter. Section 20.2031-2(b) of the Regulations provides that if there is an ascertainable market for over-the-counter securities, they are valued in the same manner as listed shares, *i.e.*, at the mean between the highest and lowest quoted selling prices on the date of valuation. If there are no sales during a "reasonable" period before and after the valuation date, then Section 20.2031-2(c) of the Regulations provides that the value is "the mean between the bona fide bid and asked prices on the valuation date, or if none, * * * [the] weighted average of the means between the bona fide bid and asked prices on the nearest trading date before and the nearest trading date after the valuation date, if both such nearest dates are within a reasonable period." This provision takes account of the fact that, depending upon a number of complex factors, unlisted shares may be purchased for an amount somewhere between the highest bid and lowest asked price. See generally, Report of Special Study of Securities Market of the Securities and Exchange Commission, H. Doc. No. 95, 88th Cong., 1st Sess., 1963, Part 2, Chapter VII, pp. 541-678. For administrative convenience, the value of these shares is the mean price between the bid and asked prices on the applicable dates.

States, 303 F. 2d 439 (C.A. 5). The court appears to have assumed that the par value of the bond in this situation is analogous to the redemption price of a mutual fund. The analogy, however, is unsound. The Treasury allows certain bonds to be applied at par against the estate tax in order to make government bonds a more attractive and secure investment for estate planning purposes. The executor of an estate which holds bonds selling at a price below par will obviously use those bonds to discharge the estate tax obligation. For this purpose, in these circumstances, the bonds are worth par, and an anomalous result would occur if the estate were able to apply the bonds at par to discharge its estate tax obligation while valuing them at the lower market price for purposes of calculating the estate tax. The requirement that bonds be valued at par in these circumstances is simply a reflection of the special value which the bonds have when used to pay estate tax at par.

Nor is the regulation under consideration here inconsistent with Treasury Regulations Section 20.2031-2(h), which provides that the traditional concepts of fair market value may be inoperative with respect to the valuation of stock subject to restrictive agreements. (Pet. 32-33.) See *United States* v. *Land*, 303 F. 2d 170 (C.A. 5), certiorari denied, 371 U.S. 862. Restricted shares, ordinarily held by corporate employees, frequently have a value in the hands of the restricted stockholder which is considerably lower than the price at which unrestricted shares could be bought or sold on the open market. If restricted shares were valued without regard to the restrictions, and in the same manner as

unrestricted shares, the valuation would be contrary to fact, and the tax consequences would work considerable hardship in many instances; indeed, this approach would operate to value shares at an amount not only greater than the restricted shareholder could receive on sale of the shares, but also greater than the amount that a willing buyer would pay for shares subject to the relevant restrictions.

Finally, we note that the mutual fund shares under consideration here are valued for income tax purposes in the same manner that they are valued for estate and gift tax purposes. Consequently, persons who have acquired these shares by devise, and in certain circumstances by gift (see Section 1015 of the 1954 Code), enjoy the benefits of the higher basis afforded by the Commissioner's decision to calculate fair market value in terms of the asked price, the price that must be paid to purchase the shares. Similarly, if mutual fund shares are donated to an exempt charitable organization, the amount of the donor's deduction is calculated with reference to the fair market value, or asked price, of the shares. See Section 1.170-1(c) of the Treasury Regulations on Income Tax (1954 Code). Had the Commissioner chosen the valuation method proposed by respondent and the courts below, income taxpayers would doubtless have claimed that it was unreasonable to value their shares for purposes of computing basis or ascertaining the amount of a charitable deduction at an amount less than it would have cost to purchase the shares on the relevant valuation date. The answer to that argument is the same as our answer here. The Commissioner has

chosen one of at least two reasonable methods of valuing mutual fund shares. In our view he has chosen wisely. But even if "improvements might be imagined," the regulation at issue falls within the Commissioner's "authority to implement the congressional mandate in some reasonable manner." *United States v. Correll, supra.*[15]

CONCLUSION

For the reasons stated, the judgment of the court of appeals should be reversed.

Respectfully submitted.

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NOVEMBER 1972.

[15] Several unsuccessful attempts have been made to amend Section 2031 of the Code to provide for valuation of shares in a mutual fund at the redemption price. The following bills have been introduced in the House of Representatives and referred to the Committee on Ways and Means: H.R. 662, 90th Cong., 1st Sess., dated January 10, 1967; H.R. 4458, 90th Cong., 1st Sess., dated February 1, 1967; H.R. 14,770, 90th Cong., 2d Sess., dated January 23, 1968; H.R. 844, 91st Cong., 1st Sess., dated January 3, 1969; H.R. 866, 91st Cong., 1st Sess., dated January 3, 1969; H.R. 2322, 92d Cong., 1st Sess., dated January 26, 1971; H.R. 2870, 92d Cong., 1st Sess., dated January 26, 1971. None of these bills has yet been reported out of committee. Although the inaction of Congress is not the equivalent of legislation, it is some evidence that Congress does not feel it necessary to legislate to overturn the regulation.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 2031 [as amended by Sec. 18(a), Revenue Act of 1962, P.L. 87-834, 76 Stat. 960]. DEFINITION OF GROSS ESTATE.

(a) *General.*—The value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated.

(b) *Valuation of Unlisted Stock and Securities.*—In the case of stock and securities of a corporation the value of which, by reason of their not being listed on an exchange and by reason of the absence of sales thereof, cannot be determined with reference to bid and asked prices or with reference to sales prices, the value thereof shall be determined by taking into consideration, in addition to all other factors, the value of stock or securities of corporations engaged in the same or a similar line of business which are listed on the exchange.

SEC. 2033 [as amended by Sec. 18(a), Revenue Act of 1962, *supra*]. PROPERTY IN WHICH THE DECEDENT HAD AN INTEREST.

The value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

Treasury Regulations on Estate Tax (1954 Code) (26 C.F.R.):

§ 20.2031-1 *Definition of gross estate; valuation of property.*

* * * * *

(b) *Valuation of property in general.* The value of every item of property includible in a decedent's gross estate under sections 2031 through 2044 is its fair market value at the time of the decedent's death, except that if the executor elects the alternate valuation method under section 2032, it is the fair market value thereof at the date, and with the adjustments, prescribed in that section. The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. The fair market value of a particular item of property includible in the decedent's gross estate is not to be determined by a forced sale price. Nor is the fair market value of an item of property to be determined by the sale price of the item in a market other than that in which such item is most commonly sold to the public, taking into account the location of the item wherever appropriate. Thus, in the case of an item of property includible in the decedent's gross estate, which is generally obtained by the public in the retail market, the fair market value of such an item of property is the price at which the item or a comparable item would be sold at retail. For example, the fair market value of an automobile (an article generally obtained by the public in the retail market) includible in the decedent's gross estate is the price for which an automobile of the same or approximately the same description, make, model, age, condition, etc., could be purchased by a member of the general public and not the price for which the particular automobile of the

decedent would be purchased by a dealer in used automobiles. Examples of items of property which are generally sold to the public at retail may be found in §§ 20.2031–6 and 20.2031–8. The value is generally to be determined by ascertaining as a basis the fair market value as of the applicable valuation date of each unit of property. For example, in the case of shares of stock or bonds, such unit of property is generally a share of stock or a bond. Livestock, farm machinery, harvested and growing crops must generally be itemized and the value of each item separately returned. Property shall not be returned at the value at which it is assessed for local tax purposes unless that value represents the fair market value as of the applicable valuation date. All relevant facts and elements of value as of the applicable valuation date shall be considered in every case. The value of items of property which were held by the decedent for sale in the course of a business generally should be reflected in the value of the business. For valuation of interests in businesses, see § 20.2031–3. See § 20.2031–2 and §§ 20.2031–4 through 20.2031–8 for further information concerning the valuation of other particular kinds of property. For certain circumstances under which the sale of an item of property at a price below its fair market value may result in a deduction for the estate, see paragraph (d)(2) of § 20.2053–3.

* * * * *

§ 20.2031–8. *Valuation of certain life insurance and annuity contracts; valuation of shares in an open-end investment company.*

* * * * *

(b) *Valuation of shares in an open-end investment company.* (1) The fair market value of a share in an open-end investment company (commonly known as a "mutual fund") is the

public offering price of a share, adjusted for any reduction in price available to the public in acquiring the number of shares being valued. In the absence of an affirmative showing of the public offering price in effect at the time of death, the last public offering price quoted by the company for the date of death shall be presumed to be the applicable public offering price. If the alternate valuation under section 2032 is elected, the last public offering price quoted by the company for the alternate valuation date shall be the applicable public offering price. If there is no public offering price quoted by the company for the applicable valuation date (e.g., the valuation date is a Saturday, Sunday, or holiday), the fair market value of the mutual fund share is the last public offering price quoted by the company for the first day preceding the applicable valuation date for which there is a quotation, adjusted for any reduction in price available to the public in acquiring the number of shares being valued. In any case where a dividend is declared on a share in an open-end investment company before the decedent's death but payable to shareholders of record on a date after his death and the share is selling "ex-dividend" on the date of the decedent's death, the amount of the dividend is added to the ex-dividend quotation in determining the fair market value of the share as of the date of the decedent's death. As used in this paragraph, the term "open-end investment company" includes only a company which on the applicable valuation date was engaged in offering its shares to the public in the capacity of an open-end investment company.

(2) The provisions of this paragraph shall apply with respect to estates of decedents dying after October 10, 1963.

Treasury Regulations on Gift Tax (1954 Code) (26 C.F.R.):

§ 25.2512–6. *Valuation of certain life insurance and annuity contracts; valuation of shares in an open-end investment company.*

* * * * *

(b) *Valuation of shares in an open-end investment company.* (1) The fair market value of a share in an open-end investment company (commonly known as a "mutual fund") is the public offering price of a share, adjusted for any reduction in price available to the public in acquiring the number of shares included in the particular gift. In the absence of an affirmative showing of the public offering price in effect at the time of the gift, the last public offering price quoted by the company for the date of the gift shall be presumed to be the applicable public offering price. If there is no public offering price quoted by the company for the date of the gift (e.g., the date of the gift is a Saturday, Sunday or holiday), the fair market value of the mutual fund share is the last public offering price quoted by the company for the first day preceding the date of the gift for which there is a quotation, adjusted for any reduction in price available to the public in acquiring the number of shares included in the particular gift. As used in this paragraph, the term "open-end investment company" includes only a company which on the date of the gift was engaged in offering its shares to the public in the capacity of an open-end investment company.

(2) The provisions of this paragraph shall apply with respect to gifts made after October 10, 1963.

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IN THE

Supreme Court of the United States

No. 71-1665

October Term, 1972

UNITED STATES OF AMERICA,
Petitioner,

v.

DOUGLAS B. CARTWRIGHT, as Executor of the Estate of Ethel B. Bennett.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

Questions Presented

The question as stated by the Petitioner (Br. p. 2) (whether the regulation is valid) is not the basic issue. The basic question is the "value" of the mutual fund shares owned by Ethel B. Bennett within the meaning of the word "value" in § 2031 of the Internal Revenue Code. The regulation is only the Commissioner's own opinion, understandably biased, of how "value" should be determined under that section. It does not preclude the Court from considering the real issues in dispute, which are:

1. Was the fair market value of the mutual funds owned by Ethel B. Bennett at the time of her death:

(a) The $124,399.87 the executor would have received for them if she had sold them on that date (*i.e.* the bid or redemption price) or

(b) The $133,325.14 the executor would have had to pay to purchase the same number of additional shares on that date (*i.e.* the replacement cost or asked price)?

2. Is the difference (the $8,925.27 that would have to be paid to the broker as a commission on the purchase of the additional shares) an asset of her estate subject to the estate tax?

Once these questions have been answered, the Court will be in a position to determine if the regulation is a fair and reasonable interpretation of the statute or an arbitrary and unreasonable one.

3. May the Commissioner, by regulation, create an irrebuttable and conclusive determination of the value of a mutual fund share, thereby depriving the taxpayer of due process guaranteed under the Fifth and Fourteenth Amendments to the Constitution of the United States?

Statement of Facts

History of the Mutual Fund Issue.

Many millions of mutual fund shares have been valued for estate tax purposes since the enactment of the Investment Companies Act of 1940.

The Commissioner has admitted that for upwards of 20 years, until 1961 or 1962, he accepted returns valuing them at the net asset value or bid price (R. 10).

Beginning in 1961 or 1962, the Treasury Department conceived the idea of increasing the revenue significantly by valuing mutual fund shares at the "asked" price, *i.e.* at

their retail price or replacement cost (the price the executor would have to pay to purchase as many additional shares as the estate already owned) (R. 10).

Hundreds and perhaps thousands of protests were registered in District and Regional Offices and some of them reached the litigation stage in both the Tax Court and as claims for refund in the District Courts where, by law, the Department of Justice represents the Treasury (R. 11).

Included were two estate tax audits in the Western District of New York. Addie G. Baldwin had died on April 2, 1960, and Ethel Louise Stern on February 22, 1961. Both executors paid the deficiency and sued for refund in the U. S. District Court for the Western District of New York at Buffalo (R. 11-12).

The Department of Justice disagreed with this new Treasury concept of valuation. On January 14, 1963, it instructed the Chief Counsel of the IRS to refund the excess tax to the Baldwin Estate and on May 28, 1963, it directed the IRS to refund the tax to the Stern Estate (R. 11-12, 15-18).

The disposition of these cases in this manner was not confined to the Western District of New York. In the Florida case of *Estate of Charles M. Wilder* (R. 12, 19) the Justice Department was more explicit, saying that it "receded" from the position taken by the Internal Revenue Service and accepted the valuation at the price at which the shares could have been sold on the valuation date (R. 19).

These administrative refunds were noted by the tax services, particularly Research Institute of America, as evidence of the disagreement between the Department of Justice and its client on this issue. It noted that the Department of Justice had conceded in litigation that the correct value was the bid price (R. I. A. Tax Coordinator, Vol. 6, Chapt. P-6202.10, p. 42,143).

The Commissioner was confronted with a dilemma. The Department of Justice would order refunds to all executors who brought suit in District Courts.

So, the Commissioner issued a regulation that effective on or after October 11, 1963, the fair market value was replacement cost. T. D. 6680, 1963-2 CB 417. No reason was offered.

Then, to clear the dockets of all cases in which an adverse decision on the issue of value would be an unfavorable precedent, the Commissioner, on February 24, 1964, announced that the IRS would refund all taxes collected on the load if the decedent died prior to October 11, 1963. Rev. Proc. 64-18, 1964-1 CB (Part I) 681 (R. 13). This enabled him to make the reasonableness of his regulation the prime issue in a Tax Court case involving persons dying after October 11, 1963.

The regulation raised a storm of protest from taxpayers throughout the country. Executors have been forced to pay the extra tax because no one in the IRS can waive the regulation. Many of them brought suit in District Courts. Many thousands more filed claims for refund. Many thousands more paid under protest.

The particular facts of this case.

At the time of her death on December 4, 1964, the decedent, Ethel B. Bennett, was the owner of these shares of open-end investment companies or mutual funds:

(a) 2,568.422 shares of Investors Mutual, Inc. in her individual name and 2,067.531 shares in her name as trustee for her daughter, Dorothy B. Cartwright.

(b) 2,269.376 shares of Investors Stock Fund Inc.

(c) 1,869.159 shares of Investors Selective Fund, Inc. (R. 22). As more fully explained hereafter, Mrs. Bennett acquired none of her shares by purchase at the public offering price.

The executor of her estate reported the value of these shares, for estate tax purposes, as their net asset value or "bid" (redemption) price of $124,399.87 and paid the estate tax computed on this basis (R. 22).

The Commissioner of Internal Revenue assessed a deficiency in estate tax based on his determination that these shares were includible in the gross estate at the price the executor would have had to pay to purchase as many additional shares as the estate already owned on the valuation date, *i.e.* the "asked" or public offering price, totalling $133,325.14. (R. 22-23).

The executor paid the deficiency with interest and filed timely a claim for a refund of federal estate tax and interest in the amount of $3,092.59 (23). The claim for refund having been denied, the executor brought suit in the United States District Court for the Western District of New York (R. 4). The District Court ruled that § 20.2031-8 (b) of the Treasury Regulations, upon which the Commissioner had based the deficiency, was unreasonable and entered judgment for the taxpayer. The government appealed this adverse judgment to the Second Circuit Court of Appeals where judgment for the taxpayers was affirmed.

Investors Stock Fund, Inc., Investors Mutual, Inc. and Investors Selective Fund, Inc. (hereinafter sometimes referred to as "the Investment Companies") are open-end investment companies registered with the Securities and Exchange Commission, are subject to the regulations of said Commission and are regulated by the Investment Company

Act of 1940, 15 USC § 80a-1, *et seq.* These funds were organized and managed by Investors Diversified Services, Inc., Minneapolis, Minnesota. Investors Diversified Services, Inc. is not an open-end investment company. It acts as underwriter in marketing or distributing the shares of the Investment Companies it has organized and acts as investment manager for them (R. 23).

Shares of these Investment Companies are distributed exclusively by Investors Diversified Services, Inc. (hereinafter referred to as "IDS") pursuant to distribution agreements with the Investment Companies (R. 25). IDS is required by § 22(d) of the Investment Companies Act of 1940, 15 USC § 80a-22, to sell the shares at the current public offering price described in the prospectus (in this instance, net asset value plus a maximum sales charge of 8% of the public offering price). (R. 25).

IDS receives, in full payment for its services as distributor of these shares, a distribution fee equal to the amount by which the public offering price exceeds net asset value. The remainder of the purchase price is the "net asset value" which is remitted to the Investment Company. From its fee, IDS pays commissions to its sales representatives and other expenses incident to or in connection with the distribution and sale of the shares (R. 25).

The public offering price is the "net asset value, ordinarily determined daily, plus a maximum sales charge of 8% of the public offering price" (Lesser commission percentages apply for quantity sales). This is generally described as the "asked" price in the financial pages (R. 24).

The "net asset value" is computed daily as of the close of trading on the New York Stock Exchange. The total

assets are valued and the total outstanding liabilities are subtracted. The resulting net worth is divided by the number of outstanding shares to determine the "net asset value" per share. This is generally described as the "bid" price in the financial pages(R. 24).

There are four ways by which a person may acquire shares of these Investment Companies, as follows:

(a) By an initial investment at the asked or public offering price (R. 26). Mrs. Bennett acquired none of her shares this way (R. 26-30).

(b) By directing the investment of dividends and capital gains distributions on shares already owned in additional shares (a person who is already a shareholder, by written authorization, may appoint IDS as his agent to reinvest his cash dividends and/or capital gains in additional shares of the respective investment company at the "net asset value" or "bid" price without any additional charge or sales commission) (R. 26). Mrs. Bennett acquired some of her shares this way.

(c) By exchanging one of these funds for shares of another of these funds (any shareholder has the right to transfer or exchange his shares in any one or more of the Investment Companies managed by IDS into or for shares of any of its other Investment Companies at "net asset value" or "bid" price without sales or service charge) (R. 26). Mrs. Bennett did not acquire any shares in this manner.

(d) By gift or inheritance. Mrs. Bennett inherited most of her shares from the estate of her husband, Arthur Y. Bennett, who died on October 1, 1962. They had been reported on his estate tax return at their "net asset value"

or "bid" price and this valuation was accepted by the Commissioner, after audit. The number of these shares doubled after his death as the result of a two for one stock split (R. 26-30).

The certificate of incorporation of each of these Investment Companies gives each registered shareholder the right to require it to redeem his shares at any time at their "net asset value" and without charge (R. 25-26). The election made by each of these Investment Companies in their certificates of incorporation to have redeemable shares was preliminary to registration with the Securities and Exchange Commission (R. 79).

Although there are no restrictions on the transferability of shares of these Investment Companies, the shareholders ordinarily dispose of them by requesting the company to redeem them (R. 25). The redemption price is their "net asset value" calculated as of the close of business on the day of receipt of the surrendered stock certificate or request to redeem by the shareholder. There is no charge for redemption (R. 26).

If a mutual fund company decides to market its own shares without a sales charge, i.e. if a "load" fund becomes a "no load" fund, the value of the shares is then publicly quoted at net asset value for the purpose of both sale and redemption (R. 60-61).

Summary of Argument

All that the Estate of Ethel Bennett could get for her mutual fund shares was $124,399.87. The Commissioner concedes this.

Nevertheless, the Commissioner valued them in her estate at $133,325.14. This was the public offering price on

the date of her death, i.e. the amount that only the issuing companies and their marketing agent could get for them on that date. The $8,925.27 difference would be the commissions paid to the marketing agent, i.e. the costs of acquiring new shares; not an element of value of the shares already owned.

The Commissioner relies on the power given to him by Congress to make such determinations, contending that Reg. Sec. 20.2031-8(b) valuing mutual fund shares at "replacement cost" is a reasonable interpretation of the word "value" as it is used in § 2031 and § 2033 of the Internal Revenue Code, i.e. that their value to the estate is properly measured by the price the executor would have to pay the Investment Companies and their marketing agent to acquire as many more shares.

The Commissioner attempts to justify his position by comparing mutual fund shares owned by a decedent with gifts of single premium life insurance policies on the life of another and gifts of diamond rings subject to wartime luxury excise taxes. The relationship is obscure but his reason is transparent. It provides at least a pretense that he was not totally unreasonable.

The true comparison is between a mutual fund share and a share of General Motors.

The price of a share of General Motors quoted in the papers does not include a purchasing commission. The Commissioner says the quoted price is its value.

The bid price of a mutual fund share quoted in the papers, likewise, does not include a purchasing commission. Contrarily, the Commissioner says the bid price is not its value.

The replacement cost of a share of General Motors is the price quoted in the papers plus a purchasing commission. The Commissioner says this is not its value.

The replacement cost of a mutual fund share is the bid price plus a load or purchasing commission (asked price). Contrarily, the Commissioner says this is its value.

After valuing mutual fund shares like shares of General Motors for 23 years after the Investment Companies Act of 1940, the Commissioner, in 1963, quite inconsistently decided that the value of a mutual fund share includes the purchasing commission.

The regulation arbitrarily ignores the best evidence of value which is the price for which the estate can sell the shares; the same test the Commissioner uses in the case of all other types of securities. If mutual fund shares were valued under the Commissioner's regulations for stocks and other securities, they would be valued at their net asset value. This interpretation, long continued without substantial change, should be deemed to have Congressional approval and the effect of law.

The Commissioner's attempt to value them since 1963 under the regulation for single premium life insurance policies on the life of another deserves no respect as a contemporaneous construction of the statute.

The regulation is out of harmony and inconsistent with the statute. Value, as the word is used in § 2031 and § 2033 of the Code, means what the property of the decedent is worth; not what a retail dealer can get from a member of the general public for the retail dealer's property, as the Commissioner contends in his brief.

The bid price and the asked price are not "reasonable alternatives" from which the Commissioner, in his discretion, can make a reasonable choice. One is right and the other is wrong. Is their value the $124,399.87 the estate could get for them? Yes. Is their value the $133,325.14 that only the Investment Companies and their marketing agent could get for them? No. The regulation is unreasonable.

The regulation purports to create a conclusive, irrebuttable presumption that value is "replacement cost" precluding consideration of any other relevant evidence or factors or elements of value. It purports to nullify any contrary evidence or contrary findings of a court of law. It deprives taxpayers of due process under the Fifth and Fourteenth Amendments.

ARGUMENT

POINT I

Applying the ordinary rules of valuation, mutual fund shares would be valued at their bid price or net asset value for estate tax purposes.

A. The price at which publicly traded shares are bought and sold is exactly the same as the prices at which mutual fund shares are bought and sold. In all cases the purchase price and the selling price is the same. The only difference is the way the price is quoted in the newspapers, the former being quoted without broker's commissions, whereas mutual fund shares are quoted inclusive of broker's commissions.

It is essential to a discussion of the issues that there be a thorough understanding of the basic sameness of the transactions in both publicly traded shares and mutual fund shares and the basic difference in the way they are quoted in the financial pages. It is best explained by an illustration.

Mr. B purchases a share of General Motors through Merrill Lynch for $100. Mr. S sells it to him through Merrill Lynch for $100. The purchase price and the selling price are both $100.

But Merrill Lynch, as the broker, is entitled to be paid for its services. Both Mr. B and Mr. S know this and agree to pay either a purchasing price or a selling commission. If Merrill Lynch charges both a 2% commission, Mr. B's total cost is $102 and Mr. S's net selling price is $98.

If the market quotations for the day included the purchasing commission and deducted the selling commission, the quotation would be $102-$98. But they do not.

The significant fact is that both the purchase price and the selling price are $100.00. This being the best evidence of the price at which the shares changed hands between Mr. B and Mr. S, the Commissioner agrees that $100.00 is the fair market value for estate tax purposes. Reg. Sec. 20.2031-2(b).

Applying the same analysis to mutual fund shares, we find that Investors Stock Fund, Inc. offers its shares to the public at their net asset value of $100. The offer is made through a distributor or marketing agent (Investors Diversified Services, Inc.) which, like Merrill Lynch, is entitled to be paid for its services as a broker. The terms of the offer are that the purchaser must pay the broker's commission (so that the fund, belonging to other shareholders, will not be diluted by selling costs). The purchaser pays $100 for the shares and, in addition, pays $8 to the broker. The selling price as far as the owner (Investors Stock Fund, Inc.) is concerned is $100. The cost to the purchaser is $108, but the cost, as far as he is concerned, is (1) $100 as the purchase price of the shares and (2) $8 for the broker.

The purchaser understands that if he later tenders his shares for redemption, his selling price to Investors Stock Fund, Inc. will be $100.00 and the redemption price to be paid by Investors Stock Fund, Inc. will be $100.00.

The only difference is that broker's commissions are not included in the quoted prices for General Motors; but are included in the quoted prices for mutual fund shares.

If mutual fund prices were quoted in the financial pages like the prices of listed stocks, the quotations would be as shown below:

Mutual Fund Prices

	Bid	Ask
Aberdeen Fnd	2.06	2.06**
Anchor Grwth	10.82	10.82*
Chase Fnd Bos	10.88	10.88*
Hartwell	13.78	13.78**
Investors Mut Fnd	10.22	10.22*
Investors Sel Fnd	9.62	9.62*
Investors St. Fnd	21.04	21.04*
Mass Inv Tr	12.42	12.42*
One William	17.89	17.89**
Putnam Grwth	12.13	12.13*
Wellington Exp	26.10	26.10*

The significant and basic fact is that Investors Diversified Services, Inc. is a marketing *agent* playing the same role played by Merrill Lynch in the sale of shares of General Motors. The 8% commission paid to it is the same, except as to percentage, as the commission paid to Merrill Lynch, Goodbody or any other broker. In one case the commission is separately stated on a confirmation slip. In the other it is included in the total.

If the fair market value of a mutual fund share is $108, the fair market value of the share of General Motors is $102. The Commissioner chooses to disagree, saying that the value of the General Motors share is $100, but that the value

*means plus commissions to be paid to the broker or distributor at the rate of 8% of the gross selling price, inclusive of the commission. Lower commission rates apply to purchases exceeding $15,000 $20,000.00, $25,000, etc.

**means "no load" funds, *i.e.* shares can be purchased direct from the fund without payment of commissions to a broker.

of the mutual fund share is $108. The Commissioner's inconsistency in valuing them differently is an incomprehensible, arbitrary and unreasonable distinction.

B. Mutual fund shares would be valued at the bid price if valued under the stock and bond regulations in Reg. Sec. 20.2031-2 (a)-(h).

The entire concept of valuation of securities for estate tax purposes, as it is set forth in the long-standing and Congressionally and judicially approved regulations of the Commissioner, is predicated on the determination of fair market value in terms of *selling* price, *i.e.*, what the estate can "get for" it Reg. Sec. 20.2031-2(a)-(h).

Subdivision (a) is introductory. Subdivision (b), (c) and (d) deal with the values of securities on national exchanges or traded in over-the-counter markets. The objective of the regulation is to get a reasonable approximation of the prices at which the estate might have sold the shares on a particular day when a listed stock like General Motors or an unlisted stock might have sold for 100⅝ in the morning and 99⅜ in the afternoon. Selling prices obtained from unofficial sources are to be substantiated by "evidences of sale". The entire phraseology of these subsections is in terms of the mean between the "highest and lowest quoted selling prices", "highest and lowest available sales prices", "based on selling prices", based on "incomplete selling prices", etc. Reg. Sec. 20.2031(b), (c) and (d).

Applying this rule to the shares in question, there is no uncertainty about the selling price available to the Estate of Ethel Bennett on the date of her death. The exact selling price is computed to the penny daily in accordance with strict SEC regulations and all such sales are made

at that price, whether the sale is by the Investment Company or by the owner. The value of few, if any, corporate securities is valued so precisely.

No adjustment is made or even permitted for the brokerage commission payable by the seller of a listed stock and the government freely admits that the broker's commission a purchaser would pay for such shares is not to be added to the selling price to determine value. Under these subsections, mutal fund shares would be valued at the bid price.

Subsection (e) entitled "Where *Selling* Prices or Bid and Asked Prices Do Not Reflect Fair Market Value" forcefully demonstrates that the probable selling price of the stock owned by the estate is the criterion to be used in estate tax cases and not what the executor would have to pay (including broker's commissions) for as many additional shares. It says in substance that if "*selling* prices or bid and asked prices do not correctly reflect the fair market value, then some reasonable modification of that basis or other relevant facts and elements of value are considered in determining the fair market value." This subsection then enunciates the "blockage" rule saying that "If the executor can show that the block of stock to be valued is so large in relation to the actual *sales* on the existing market that it could not be liquidated in a reasonable time without depressing the market, the price at which the block could be *sold* as such outside the usual market, as through an underwriter, may be a more accurate indication of the value than market quotations." (Emphasis added.)

It is clear from the judicial development of the "blockage rule" that liquidation values and appraised selling prices are controlling in securites valuation in recognition of the

obvious economic fact that a sudden unloading of a large quantity of a commodity tends to drive the price down.

It is interesting to note that this rule was long opposed by Treasury. *Helvering v. Safe Deposit and Trust Company of Baltimore*, 95 F. 2d 806; *Helvering v. Kimberly*, 97 F. 2d 433; *Commissioner v. Shattuck*, 97 F. 2d 790; *Helvering v. Maytag*, 125 F. 2d 55, cert. den. 316 U. S. 689; *Jenkins v. Smith*, 21 F. Supp. 251. The Internal Revenue Service finally acquiesed and issued Reg. Sec. 20.2031-2(e) in conformity with these decisions. A regulation was needful. It defined value in terms of its *value* to the estate.

Subsection (f) provides guidelines for the valuation of the stock of closely held corporations for which there is no public market. This is the section the Commissioner uses to value the stock of a private investment company, using exactly the same criteria used in the determination of the net asset value of mutual fund shares.

The Commissioner has amplified his understanding of how to value the shares of a private investment company in Rev. Rul. 59-60, 1959-1 CB 237, at page 243, as follows.

> "(b) The value of the stock of a closely held investment or real estate holding company . . . is closely related to the value of the assets underlying the stock. For companies of this type the appraiser should determine the fair market values of the assets of the company . . . The market values of the underlying assets give due weight to potential earnings and dividends of the particular items of property underlying the stock, capitalized at rates deemed proper by the investing public at the dates of appraisal. A current appraisal by the investing public should be superior to the retrospective opinion of an individual. For these reasons adjusted net worth should be accorded greater weight in valuing the stock of a closely held investment or real estate holding company, whether or not family owned, than any of the other customary yardsticks of appraisal. . ."

Clearly, mutual fund shares would be valued at the bid price if valued under Subsection (f) and the Commissioner's interpretation of it in valuing a private investment company. The ruling says it may be proper to discount the net asset value of a private investment company by the cost of liquidating it. It makes no sense that he should value a private investment company at a discount and a mutual fund company at a premium.

Subsection (g) is not relevant, but subsection (h) dealing with securities subject to an option or contract to purchase is very relevant indeed, because of the contractual obligations entered into between mutual fund shareholders and the investment companies. Their promise to redeem shares, made a part of their certificates of incorporation and renewed in the prospectus, becomes a matter of contract when accepted by the shareholder when he purchases shares. This is a bona fide arms-length business arrangement.

Subsection (h) was promulgated in recognition of the fact that stock subject to a redemption or option agreement cannot possibly be sold for more than the agreed price and that it would be illusory to consider its value to the estate to be anything but that price. Like (f) it is tailor-made" for valuing mutual fund shares.

In summary Reg. Sec. 20.2031-2, as presently written, contains theories of valuation of stocks and securities which antedate the 1939 Code, survived all the revisions of law made by the Internal Revenue Code of 1954 and still remains unchanged 17 years later. They were a contemporaneous construction or interpretation of the word "value" as it appears in § 2031 of the Code and, in general, must be presumed to fairly and reasonably reflect the intent of Congress that fair market value is to be determined in terms of what the estate can sell it for, *i. e.* its value to the estate.

C. Actual sales of mutual fund shares are the best evidence of their value.

Evidence of what the identical property sold for is universally considered competent, substantial and persuasive evidence of its fair market value on the material date. *Douglas Hotel Co. v. Commissioner,* 190 F. 2d 766 (8th Cir. 1951). It is the "very best of evidence" because it is directly reflective of market value. *Slater v. Commissioner,* 1959 TC Memo. 125; *Cf. Visile v. State,* 30 AD 2nd 1042 (4th Dept. 1968), aff'd 24 NY 2d 966 (1969).

The very best evidence of what owners were selling their shares for to the Investors Companies on the date of Mrs. Bennett's death was the redemption price quoted in the *Wall Street Journal* for that day. It was the only price any owner, living or deceased, could get for such shares on that date in the normal course of business. The government concedes this (Stip. 12-14, R. 25-26) and has made no effort to prove otherwise.

After her death some of her beneficiaries sold the mutual fund shares inherited from her at the bid price (Stip. 32 and 34, R. 31). These actual sales are also directly reflective of and the best evidence of fair market value.

In fact, it is matter of statutory law that all an owner gets for his mutual fund shares through redemption is their net asset value. Investment Companies Act, 15 USC, § 80a-2 (32).

It is also a matter of statutory law that the new investor must pay the commission of the marketing agent. Investment Companies Act, 15 U. S. C. Section 80-22(d). Therefore, the price others must pay to the investors companies and as commissions to their marketing agent for new shares is the worst possible evidence of what the estate could get for the shares it already owns.

That the actual sale price is the best evidence of value has recently been acknowledged by the Internal Revenue Service in Rev. Rul. 70-512, 1970-2 C. B. 192, where the Commissioner held that the actual selling price of stock sold during the one-year period following the date of decedent's death is the best evidence of value for estate tax purposes, making resort to the valuation formulas set out in the regulations neither necessary nor appropriate.

Reg. Sec. 20.2031-8(b) completely ignores the best evidence of value.

D. The net asset value (bid price) meets all the conditions of the willing buyer-willing seller test whether the sale is to a new investor at the asked price or back to the company at the bid price.

Reg. § 20.2031-1(b) provides that "the fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under a compulsion to buy or sell and both having reasonable knowledge of relevant facts". The net asset value meets all the conditions of this formula; the asked price does not, as explained below:

Sales at the public offering price.

The willing seller of the shares purchased by a new investor is the open-end investment company. It sells at net asset value. The new investor is a willing purchaser at net asset value payable to the mutual fund plus a sales commission payable to IDS.[1]

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[1] George Hartley, Director of Funds Accounting and Service and Assistant Director of the six Investors Companies, testified that the mutual funds are the sellers; that at no time does IDS ever own the shares; that IDS is an agent performing a marketing function only; that the sales charge is paid to IDS and that no part of it goes to the mutual fund. R. 71-72, 74-75.

The Prospectus explains to the new investor that the mutual fund company is a willing seller at net asset value and that he is paying the commissions of its agent, as follows:

> "IDS receives, in full payment for its services as distributor of shares of Capital Stock of the Company, a fee equal to the difference between the amount received with each application and the asset value of the shares sold pursuant to such application, determined as stated in Section 15 which also gives the present rate of distribution fee." (Exh. 3, 4, 6, Section 16, page 14.)

The financial statement certified by Peat Marwick Mitchell & Co., confirms this in the "Notes to Financial Statements" saying:

> "Sales charges were not an expense of the Company. They are deducted from and are not included in the proceeds of sales of capital stock as shown in the accompanying statements of paid-in surplus. From such charges IDS pays commissions to saleman, salaries and other sale expenses." (Exh. 3, 4, 6. Financial Statements, page 26.)

This is substantial evidence that the net asset value is the price at which shares change hands between willing buyers and willing sellers.

Reinvestment of dividends in capital gains.

Owners of the investors companies shares are permitted, in fact encouraged, to reinvest their dividends in capital gains in additional shares at net asset value and without the payment of a sales charge (Exhibit 3, 4, 6). The fact that shareholders reinvested 31.13% of the cash distribution to which they were entitled in 1964 (R. 83) is substantial evidence that they were willing purchasers and that the investment companies were willing sellers at net asset value.

Exchange of shares of one of the investors companies for shares of another at net asset value.

Shareholders of Investors Stock Fund, Inc. are permitted to exchange their shares for shares of Investors Mutual, Inc. (for example) at net asset value and without sales charge. In 1964 these exchanges accounted for 11.69% of the sales of shares of these investment companies (R. 83). This too is substantial evidence of the price at which shares change hands between willing buyers and willing sellers.

Redemption at the bid price.

All sales by owners of mutual fund shares to and all purchases of mutual fund shares by the investor's companies (redemptions) are at net asset value. There is no intermediary or agent and no redemption charge, leaving as the only question whether both are willing buyers and willing sellers at the redemption price. The millions of shares that are tendered by shareholders and redeemed by investment companies each day at the bid price are irrefutable proof that the net asset value is the price at which shares change hands between willing buyers and willing sellers.

E. The net asset value has been recognized for over 20 years as the fair market value in the Investment Companies Act of 1940, by the Securities and Exchange Commission, the National Association of Underwriters and Securities Dealers, the mutual fund companies and the brokers and public generally.

Reg. Sec. 20.2031-1(b)—Valuation of Property in General—states that "All relevant facts and elements of value as of the applicable valuation date shall be considered in every case."

It is surely relevant that the net asset value is universally recognized (except by the Commissioner) as representing the value of a mutual fund share. Some of the relevant facts are:

1. Congress itself was explicit in its definition of the value of redeemable securities when it enacted the Investment Companies Act of 1940. A "redeemable security" is defined in the Investment Companies Act as any security "under the terms of which the holder . . . is entitled to receive approximately his proportionate share of the issuer's current net assets or the cash equivalent thereof." 15 USC, § 80a-2(32). The *value* of the net assets of the registered investment company from which the holder is entitled to receive his proportionate share is defined in § 80a-2(41) as being their current market value (of the underlying assets).

2. § 80a-22(d) prohibits the sale of any redeemable security except at "a current offering price described in the prospectus". The "current offering price" is the "net asset value" (which goes to the Investment Company) plus a sales commission (which goes to the marketing agent).

3. § 80-a2(35) defines the "sales load" as being "the difference between the price of a security to the public and that portion of the proceeds that is received and invested by the issuer." Nowhere in § 80a-2(35) or in any other section of the Investment Companies Act is the sales load identified with value or valuation. It is reflected in the public offering price, but the Investment Companies Act makes it clear that the sales load is available only to the agent, whether he be a broker, a dealer, a promoter or underwriter.

4. The entire theme of the prospectus issued by these Investors companies is based upon *value* in terms of net asset value. The shares are offered at net asset value. The shareholder is to receive the net asset value if he tenders his shares for redemption or the equivalent in net asset value if he exchanges the shares of one IDS affiliate for shares of another. Nowhere in the prospectus is there any suggestion that the sales charge is of any significance to the purchaser in terms of value. Item 17, entitled "Redemption of Shares", makes it abundantly clear that the *value* of the shares to anyone, alive or dead, will be the "asset value calculated as of the close of business on the day of receipt of the surrendered stock certificate or request." Exhs. 3, 4, 6.

The "Illustrations of Assumed Investment Programs" published in chart form in the prospectus specifically state, in accordance with SEC regulations, that the $10,000.00 initial investment has an initial asset value of $9,200.00 (R. 47). This is explained in a footnote as follows:

> "Initial net asset value is the amount received by the Fund after deducting from the cost of the investment the sales commission as described in the prospectus." (Exh. 3, 4, 6. Section 11, page 7).

5. § 80a-29 requires each investment company to file annual reports and render annual reports to the shareholders conforming to the rules of the SEC. Value is always expressed in terms of net asset value (R. 45-47).

The financial statements and computation of capital stock and surplus of these corporations are all computed in their annual reports in terms of the net value of the assets. Stockholders are told that "net asset value of your shares on October 31 of this year amounted to a record high of $21.12 compared with $18.83 per share at the close of

the preceding fiscal year." The sales charge is not an element of value on the books of the Investors' companies, because it is paid to Investors Diversified Services, Inc. and disappears in the form of commissions and selling expenses of the distributor. Exhs. 1, 2, 5; (R. 74-75).

6. The expert testimony of Fred Cohn explained the concept of valuation as it is used in the industry[2]. He testified that the public offering price or asked price is never used as the value of mutual funds in that industry (R. 48) and that the use of the net asset value as the criterion is in accordance with the official policy of the Securities and Exchange Commission and the National Association of Securities Dealers. (R. 45).

His firm has always valued mutual funds at the bid price, both for portfolio purposes and for estate tax purposes (R. 54-55) and, based on his more than 20 years of experience in the investment business and in preparing and compiling the data appearing in the "Johnson Charts", he does not agree that these shares should be valued at the asked price. (R. 55).

7. One of the most impressive of the relevant facts is that none of the many hundreds of Revenue Agents who audited estate tax returns between 1940 and 1961 saw fit to raise the issue on his own initiative.

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[2] Executive Vice President of Hugh Johnson & Co., Inc., a Buffalo brokerage firm with approximately 200 employees with membership on the New York Stock Exchange, doing about 30% of its gross business in the sale of mutual fund shares and the compiler and publisher of the "Johnson Charts", an annual publication sold to investment dealers and financial institutions throughout the country containing performance charts on about 193 mutual funds and pertinent information on a total of 491 mutual funds. (R. 39-44).

The Court must wonder why the Commissioner, with access to all of the knowledge and experience of the Securities and Exchange Commission, its official studies and reports and its personnel so highly qualified to testify about investment companies and the value of mutual fund shares, has studiously avoided giving the Court the benefit of its expertise in this field. The reason is that his sister agency would tell him he is completely wrong in thinking that the load is anything but an element of cost,[3] adding nothing to the value of the shares.

F. The Commissioner's long-standing interpretation of the statute should be deemed to have congressional approval and the effect of law.

For a period of at least 21 years (1941-1961) the Internal Revenue Service accepted the net asset value or redemption price as the "value" of mutual fund shares for estate tax purposes. (R. 8-12). The Commissioner's own

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[3] The latest SEC study contains such statements as "no-load shares and load shares are substitutes for each other. The only difference between them is that an investment in one entails the payment of a sales charge, which goes not to the fund itself but to the organization that does the selling." "The charge is divided among the principal underwriter, the retail dealer and the salesman who actually makes the sale." "The sales load is purely a payment for sales effort." "Section 22 (d) of the Investment Company Act of 1940 permits mutual fund managers to fix the prices at which fund shares are sold to the public and requires that all retail dealers adhere rigidly to such prices. The wisdom of this 32-year old resale price maintenance provision has been hotly debated. Many think that it simply raises investors costs without conferring any compensating benefits on them or on the public interest. Others maintain that resale price maintenance is so basic to the mutual fund distribution process that its removal would have a devasting impact on the investment company industry, the capital markets, and perhaps on the economy as a whole." Report of the Staff of the SEC "On the Potential Economic Impact of a Repeal of Section 22 (d) of the Investment Company Act of 1940" published in CCH, Federal Securities Law Reports, No. 450, Part II, dated November 15, 1972. (Quotations from page 1 of transmittal letter of Chairman William J. Casey and pages A-3 and A-93 of the Report).

prior and long-standing construction of the statute is persuasive evidence that this was the correct interpretation of their value. *Hanover Bank v. Commissioner*, 369 U. S. 672, 686 (1962).

The regulation published on October 9, 1963, is not a contemporaneous construction of the estate tax statute which has been in effect for upwards of 40 years. It was issued 23 years after the Investment Companies Act of 1940. The estate tax sections of the Code have been the subject of numerous major and minor revisions during the intervening years when the Commissioner was interpreting the statute as imposing a tax on the redemption value. He requested no legislation to authorize him to value them at replacement cost and received no Congressional rebuke as to his administration of the estate tax laws in this regard.

"This case comes within the settled principle that 'Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially re-enacted statutes, are deemed to have received Congressional approval and have the effect of law'". *United States v. Correll*, 389 U. S. 299, 305-306 (1967).

POINT II

The regulation was a deliberately planned effort to circumvent the position of the Department of Justice. It was added to Reg. Sec. 20.2031-8 for strategic and ulterior purposes.

A. The regulation was issued because the Department of Justice was instructing the IRS to refund estate taxes collected on the "asked" price and to substitute a new issue (whether the regulation was completely unreasonable instead of what is the fair market value) which the Commissioner could argue in the Tax Court without having to be represented by the Department of Justice.

The history of the mutual fund issue as it appears in the Statement of Facts (pp. 2-4) is based upon "Admissions Requested by Plaintiff and Revised by Defendant in his Answer to the Request" (R. 10-14) and letters from the Department of Justice ordering refunds of taxes collected by the Internal Revenue Service (R. 15-21).

In substance the Commissioner was being frustrated by the Department of Justice. He was stymied unless he could use his own legal staff to argue his position in the Tax Court. His position was weak on the question of value. But, a formal regulation would be viewed with considerable respect. Taxpayers would have the burden of proving him unreasonable, arbitrary and capricious by overwhelming evidence.

The Commissioner's confidence in this strategy was not wholly unfounded. He used the *Francis Foster Wells* case, the first case on the Tax Court docket involving a mutual fund owner dying after October 11, 1963, to test his theory. All but six of the judges of the Tax Court, in *Francis Foster Wells v. Commissioner*, 50 TC 871, accepted the proposition

that the sole issue before them was whether or not the Commissioner had been completely unreasonable, arbitrary and capricious and held that the taxpayer had failed in his burden of proof. Six of them disagreed, concurring in the brilliantly expressed and perceptive dissent of Judge Tannenwald. But the regulation had jumped its first hurdle.

The Department of Justice is obliged by statute to represent the Commissioner in the Federal Courts. It thus became obliged to defend a theory of valuation it had previously opposed. It succeeded in persuading the Sixth Circuit of Appeals to affirm the Wells case in *Ruehlmann v. Commissioner*, 418 F. 2d 1302 (1969), the rationale of which was copied by the Seventh Circuit Court of Appeals in a gift tax case, *Howell v. United States*, 414 F. 2d 45 (1969).

Respondent contends that it is quite relevant for the Supreme Court to know that the regulation was not the product of a considered judgment; that it was an arbitrary expedient to put the entire weight of the government on the taxpayer—to multiply his burden of proof and to halve his chance of getting judicial relief—with full knowledge that millions of taxpayers would have to "knuckle under" because they could not afford to litigate the reasonable versus unreasonableness issue on which the judicial presumption is weighted heavily against them.

B. The Commissioner amended the "Valuation of Certain Life Insurance Annuity Contracts" regulations instead of the securities regulations for strategic reasons.

The Commissioner mapped his strategy with unusual care. The obvious regulation to be amended was Reg. Sec. 20.2031-2—"Valuation of Stocks and Bonds". But, if the new regulation was added there it would have stuck out like a sore thumb by way of contrast with the long established methods of valuing securities at their value to the estate.

However illogical, the strategic answer was to insert the mutual fund replacement theory in Reg. Sec. 20.2031-8 entitled "Valuation of Certain Life Insurance and Annuity Contracts" which already contained a suggestion of the replacement cost theory.

It is the taxpayer's contention that the Commissioner snuggled the mutual fund regulation as close as he could to the replacement cost theory used in the valuation of single premium life insurance policies on the life of another for the specific purpose of making it more difficult for the taxpayer to show that his action was wholly unreasonable, arbitrary and capricious or completely without precedent.

Simple proof of this duplicity is found in the estate tax return (Form 706) in which the mutual fund regulation is included in the instructions governing the reporting of stocks and other securities in Schedule B. It has never been mentioned in the instructions for Schedule D (Insurance). It has no rational connection with single premium life insurance policies or annuities, but that was the only way the Commissioner could claim it was somewhere in the orbit of his distorted version of *Guggenheim v. Rasquin*, 312 U.S. 254.

C. The mutual fund regulations are only part of a larger scheme to substitute the replacement cost theory for long accepted concepts of valuation of assets comprising an estate.

Treasury Decision 6680, valuing mutual funds at the replacement cost, seems to have been the opening wedge in the Treasury's attempt to legislate a new criterion for the valuation of property subject to estate tax, *i.e.* to substitute replacement cost for value. Its next move was another startling departure from the theory of valuation that had

prevailed during the preceding 30 to 40 years period. On June 7, 1965, it amended Reg. Sec. 20.2031-1 (b) entitled "Valuation of Property in General" by inserting three sentences (T. D. 6826, 1965-2 C. B. 367), as follows:

> "Nor is the fair market value of an item of property to be determined by the sale price of the item in a market other than that in which such item is most commonly sold to the public, taking into account the location of the item wherever appropriate. Thus in the case of an item of property includable in the decedent's gross estate, which is generally obtained by the public in the retail market, the fair market value of such item of property is the price at which the item or a comparable item would be sold at retail. For example, the fair market value of an automobile (an article generally obtained by the public in the retail market) includable in the decedent's gross estate is the price for which an automobile of the same or approximately the same description, make, model, age, condition, etc. could be purchased by a member of the general public and not the price for which the particular automobile of the decedent would be purchased by a dealer in used automobiles. Examples of items of property which are generally sold to the public at retail may be found in §§ 20.2031-6 and 20.2031-8."

The significance of this amendment should be apparent from the simple illustration which follows.

At the time of his death Mr. A owns a 1968 Buick Electra. If his widow wanted to, she could sell it to the local dealer for $2,400.00. She decides to keep it. At about the same time, Mr. B sells his 1968 Buick Electra to the dealer for $2,400.00.

The dealer invests another $400.00 to clean the motor and upholstery, install new tires, do the necessary body work, fix the radio and otherwise recondition the car for sale on his lot for $3,000.00, hoping to get enough to pay his salesman's commission and make a profit.

If Mrs. A had sold the car for $2,400 instead of keeping it, the Commissioner would agree that the actual selling price was the best evidence of its value for estate tax purposes. Rev. Rul. 70-512, 1970-2 C. B. 192. The $2,400 which Mr. B got for his Buick is equally persuasive evidence that her car was worth $2,400 at the time.

But, the Commissioner says that the fair market value of Mrs. A's car is $3,000, because that is what Mrs. A would have had to pay to purchase Mr. B's car from the dealer.

The Commissioner has to know he is wrong. The $600 difference was used by the dealer to pay for parts, the wages of his mechanics, the commission to his salesman and for overhead in his dealership. It is incomprehensible that the $600 could possibly be an *element of value* to Mrs. A. It is part of the *cost* of acquisition of the buyer of a reconditioned Buick Electra and nothing more. But the extra tax revenues on a few hundred thousands of automobiles a year is tempting.

The editor of the section on "Valuation of Property" for the Research Institute of America says much the same thing in a Tax Coordinator (Volume 6, paragraph P-6002.2) in which he describes the Treasury's "retail" valuation rules. He says:

> "But in '65 the Treasury changed the meaning of this basic rule for valuing property which is generally obtained by the public in the retail market so that the hypothetical seller is not the taxpayer, but rather some commercial seller . . . Under this rule the gift tax value of Mr. Smith's Cadillac, above, is not the $3,400 for which he could sell it, but rather the higher price a used car dealer would get for it, say $4,000."

The editor also noted the effort that the Treasury Department was making to extend the replacement cost theory

on a wide scale to other property by incorporating his new theory in various private rulings in regulation form.

This "retail market" theory of valuation of automobiles and household and personal effects has been in the regulations for nearly six years. It is not being enforced in the field; if it ever is, there will be a flood of petitions to the Tax Court and refund claims in the District Courts because the idea is completely unacceptable.

Undoubtedly, the Internal Revenue Service is reluctant to test this theory with an automobile until it has finally nailed down the replacement cost theory in the mutual fund cases. An adverse decision would put the mutual fund issue in too clear a perspective.

Just as in the case of mutual funds, there are two markets, so to speak, for automobiles. The first is the retail market or retail price at which the manufacturer, through its enfranchised retail sales organization, sells new cars. The second, the "trade in" or "used" car market, is the only market or price available to the owner of a used automobile; not even the retail price of a used car, just the "as is" price he can get for it in the open market. It is completely incongruous for the Commissioner to value a decedent's used belongings and secondhand property at "retail".

The regulation can only be interpreted as a bold attempt by the Commissioner to (1) change the traditional willing buyer-willing seller test to a willing buyer-willing "retail dealer" concept and (2) redefine value in terms of replacement cost, both of which are beyond his province and solely within the legislative jurisdiction of the Congress.

None of these regulations were "needful" after upwards of 40 years of undisputed acceptance of the Commissioner's

method of determining the value of automobiles, boats, pianos, silverware, jewelry, etc. for estate tax purposes under Reg. Sec. 20.2031-6 and over 20 years of non-controversial valuation of mutual funds under Reg. Sec. 20.2031-2.

The Commissioner's new regulations are clearly intended to legislate the method which would produce the greatest revenue without regard to well-established concepts of fair market value.

POINT III

The regulation is inconsistent with § 2031 and § 2033 of the Internal Revenue Code.

§ 2031 is specific that it is the "value" of all property forming "the gross estate of the decedent" that shall be determined; not the "cost" of property bought by another.

§ 2033 provides:

> "The value of the gross estate shall include the value of all property *to the extent of the interest therein of the decedent* at the time of his death." (Emphasis supplied)

The Ninth Circuit Court of Appeals, in *Robert C. Davis v. United States*, 460 F. 2d 769, decided May 23, 1972, said:

> "By no stretch of the imagination does the decedent have an interest in the $.37 per share difference representing the sales load. He cannot make a transfer so that his transferee may realize this amount; he cannot realize it himself either as a part of his own certificate or separated from it. The sales load is similar to a broker's commission charged on the purchase of stocks listed on a stock exchange. Under Treasury Regulation § 20.2031-2(b) the sales charge is not part of the gross estate."
>
> . . . .

"To apply the estate tax rate to the sales charge paid is to impose a tax on a non-existent 'interest of a decedent'. The regulation which permits it, Treasury Regulation § 20.2031-8 (b), is inconsistent with the Internal Revenue Code of 1954, as amended, and specifically with 26 USC § 2033."

The statute says "value"; not "cost". They are not synonymous. Cost of comparable contracts, replacement cost, retail price, etc. are only some evidence of value. In some case, like a share of General Motors, replacement cost exceeds value by the amount of the broker's commission. In the case of a mutual fund share it exceeds value by 8%.

In the case of a deceased lawyer's library, replacement cost could exceed its value in the estate by 300% ($15,000.00 versus $5,000.00). In the case of a decedent's stately old mansion on a once fashionable street now the victim of urban blight, replacement cost may exceed its current value by 1,000% ($300,000.00 versus $30,000.00).

By substituting the replacement cost or retail price of property bought by someone else for the value of the interest of a decedent in his own property, the Commissioner has created a rule completely out of harmony with the statute.

". . . Regulations 'are not absolute rules of law' and should not be followed when they are in conflict with the 'design' of the applicable section of the Code." *Dorfman v. Commissioner,* 394 F. 2d 651 (CCA-2, 1968). The Commissioner's authority "does not extend to the establishment of rules of substantive law creating presumptions of fact which are out of harmony with the statute involved." *Commissioner v. Produce Reporter Co.,* 207 F. 2d 586, 587 (CCA-7, 1953). "Where a regulation is an amendment or a modification of a statute and therefore beyond the power of the Commissioner to make . . ." It will not

be sustained. *Gamman v. Commissioner*, 46 TC 1, 8 (1966). Interpretative regulations of the Commissioner which are arbitrary and discriminatory are void. *Rogers v. U. S.*, 265 F. 2d 615 (CCA-3, 1959); *Willett v. Commissioner*, 365 F. 2d 760 (CCA-5, 1966).

The following quotation from the decision of this Court in *Manhattan General Equipment Company v. Commissioner*, 297 U. S. 129, 134, is appropriate:

> "The power of an administrative officer or board to administer a federal statute and to proscribe rules and regulations to that end is not the power to make law —for no such power can be delegated by Congress— but the power to adopt regulations to carry into effect the will of Congress as expressed by the statute. A regulation which does not do this, but operates to create a rule out of harmony with the statute, is a mere nullity."

POINT IV

The regulation is unconstitutional under the holding in Heiner v. Donnan, 285 U. S. 312.

A. It creates a conclusive presumption of fact as to value which the taxpayer is forbidden to controvert and which precludes consideration of "all relevant facts" in violation of due process under the Fifth and Fourteenth Amendments.

The regulation is inherently arbitrary in its attempt to usurp the power of the judiciary to make a determination based on "all relevant facts and elements of value . . . in every case". Reg. Sec. 20.2031-1(b).

Even if the executor had sold all of the shares as of the date of the decedent's death for their net asset value (thereby providing the Court with the best evidence of their value as of that date) the regulation would still arbitrarily value them at replacement cost. It purports

to create a conclusive presumption as to the correct "value" for estate tax purposes. It lacks due process because it imposes a "value" which is inherently arbitrary and was designed to deprive the taxpayer of the right to submit contrary proof or other evidence bearing on "value".

This Court, in *Heiner v. Donnan,* 285 U. S. 312 (1932), held that even Congress could not create a conclusive presumption in the Tax Law, saying:

> "There is no doubt of the power of Congress . . . . to create a rebuttable presumption that gifts made within a period of two years prior to death are made in contemplation thereof. But the presumption here created is not of that kind. It is made definitely conclusive—incapable of being overcome by proof of the most positive character. Thus stated, the first question submitted (Does the second sentence of §302 (c) of the Revenue Act of 1926 violate the due process clause of the Fifth Amendment to the Constitution of the United States?) is answered in the affirmative by Schlesinger v. Wisconsin, 270 U. S. 230 . . . . and Hoeper v. Tax Commission, 284 U. S. 206 . . . ." . . . . .
>
> "The Schlesinger case has since been applied many times by the lower Federal Courts, by the Board of Tax Appeals, and by state courts and none of them seemed to have been at any loss to understand the basis of the decision, namely, that a statute which imposed the tax upon an assumption of fact which the taxpayer is forbidden to controvert, is so arbitrary and unreasonable that it cannot stand under the Fourteenth Amendment.". . . . .
>
> "Nor is it material that the Fourteenth Amendment was involved in the Schlesinger case, instead of the Fifth Amendment, as here. The restraint imposed upon legislation by the due process clauses of the two amendments is the same."

The holding in *Heiner v. Donnan* has had great vitality in the fields of both statutory and adminstrative law. Some of the cases in which the courts have seen fit to assert the

constitutional right of the citizen to judicial relief from arbitrarily conclusive administrative determinations include: *Reinecke v. Smith*, 61 F. 2d 324 (CCA-7, 1932); *Commissioner v. Shattuck*, 97 F. 2d 790 (CCA-7, 1938); *Commissioner v. Clark*, 202 F. 2d 24 (CCA-7, 1953); *Mourning v. Family Publication Services, Inc.*, 449 F. 2d 235 (CCA-5, 1971); *Carrington v. Rash*, 380 U. S. 89; *Dunn v. Blumstein*, ____U. S. ___, 31 L. Ed. 2d, 274 (1972).

This case is solidly within the rule of *Heiner v. Donnan*. The trial judge found, as a fact, on the basis of uncontroverted evidence that the value of Mrs. Bennett's mutual fund shares was $124,399.87; not $133,325.14. Judge Hauk, in *Robert C. Davis v. United States*, 306 F. Supp. 949, made a factual finding on the evidence that the value of the mutual funds in the Davis Estate was their net asset value. A similar finding was made by the trial court judge in *Hicks v. United States*, 335 F. Supp. 474.

The Commissioner's position necessarily is that even if every trial court in the United States were to make a similar finding of fact, his regulation is irrebuttable, conclusive and binding both on the taxpayers and on the courts.

This taxpayer is confident that this Court will not countenance such a bold denial of due process of law.

POINT V

Reply to appellant's brief.

The government's brief does about all that can be done in support of the Commissioner's new theory. It paraphrases the arguments used by the Tax Court in *Frances Foster Wells v. Commissioner*, 50 TC 871, in the decision which affirmed that case, *Ruehlmann v. United States*, 418 F. 2d 1302 and *Howell v. United States*, 414 F. 2d 45, in

such a way as to make them appear to give at least some support to the claim that the Commissioner was not completely unreasonable in issuing the regulation.[4]

In addition to the arguments extracted from the cases cited above, the government's brief contains a few peripheral arguments for which no authorities are cited. These are based upon assumed facts of which no proof was offered at the trial and for which there is no support in the record.

These arguments, all of which are necessarily theoretical, hypothetical and legalistic are described below in separate subheadings with appropriate discussions as to each.

A. The "reasonable alternatives" argument (Br. p. 9).

This is not an "area of limitless factual situations" as existed in *United States v. Correll,* 389 U.S. 299 (when is a taxpayer away from home?) or *Bingler v. Johnson,* 394 U. S. 741 (what is a fellowship or scholarship?), where the Commissioner had a choice of many definitions, a number of which were equally reasonable, though not necessarily perfect, definitions.

Here there are only two possible answers, one of which is right and reasonable, the other wrong and unreasonable.

This Court faced similar questions in such cases as *Eisner v. Macomber,* 252 U. S. 189 (does a stockholder realize taxable income from a stock dividend or doesn't he?) and *Mass v. Higgins,* 312 U. S. 443 (is the income received

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[4] None of these cases, *Wells v. Commissioner* (*supra*), *Ruehlmann v. C. I. R.* (*supra*) or *Howell v. United States supra,* looked first to the facts to determine the real value of a mutual fund share before passing on the reasonableness of the regulation. They seem to have been concerned only with the legalistic argument that the regulation must be sustained unless the taxpayer proves it to be so completely unreasonable as to be invalid.

during the year after death taxable as property belonging to the decedent when he died or isn't it?). One answer would be right, and the other wrong. The following quotation from *Mass v. Higgins* is tailormade for the facts of this case:

> "The petitioners insist that the government's position is unreal and artificial; that it does not comport either with economic theory or business practice; and that the regulation is an unwarranted extension of the plain meaning of the statute and cannot, therefore, be sustained. We hold that the petitioners are right."

A mutual fund share, like a car or any other product with a tradein or resale value, sells at two prices or in two makets, so to speak, depending upon who is selling it.

Only a registered and regulated investment company and its marketing agent or retail sales organization has access to the retail market "asked" price for its new shares. 15 U. S. C. § 80a-2, 7, 22 (d).

The only market or price to which the owner or his estate has access is the "used", so to speak, or "bid" price market. It is totally unrealistic for the Commissioner to contend that both the public offering price and the bid price are reasonable alternatives to assign to shares owned by an estate. The estate has only one choice. The Commissioner is completely unreasonable in saying he has two.

Here issue was joined in the trial court on the question as to the value to the estate within the meaning of § 2031 of the Code. The trial court's findings, based on all the facts, were that the only price available to the estate was the bid price; that the public offering price available to the issuing company was incorrect, unrealistic and unreasonable and, as a necessary corollary, that the regulation is invalid.

The Commissioner made no attempt to show that the public offering price was in any way a reasonable alternative price available to the estate, placing sole reliance on his regulation. Lacking any support in the record, the Commissioner should be precluded by his own failure of proof from now contending that there are two reasonable alternatives from which he may make a choice in his discretion.

B. The "Guggenheim case" argument (Br. p. 12-13).

It was predictable from the insertion of the mutual fund regulation in the "single premium life insurance on the life of another" regulation that the Commissioner was trying to get more mileage out of the *Guggenheim* case in terms of estate taxes, even though it was a gift tax case.

The decisions in the lower courts have effectively disposed of this argument and there is no need to summarize what the Court will read in any event.

It might be helpful, though, if the writer could demonstrate, by a simple analogy, the extent to which the Commissioner has, by regulation, tortured the reasoning in the *Guggenheim* case for estate tax purposes.

A thoughtful husband purchases a Buick Electra for his wife in 1965 at a cost of $6,000.00. There is no question that he made a $6,000.00 gift; just as surely as if he had given her $6,000.00 to go buy it for herself. He would be wrong, just as Mrs. Guggenheim's tax adviser was wrong, in claiming that the amount of the gift was the $5,400.00 the car was worth once she drove it to the store.

If his check to the dealer had been for $6,300.00 to include a 5% sales tax, the amount of the gift would have been $6,300.00; just as surely as if he had given her $6,000.00 to pay for the car and $300.00 to pay the sales tax. So, the people who prepared the gift tax returns for Mr. Gould

(*Gould v. Commissioner,* 14 TC 414), Mrs. Publicker (*Publicker v. Commissioner,* 206 F. 2d 250) and Mr. Duke (*Duke v. Commissioner,* 200 F. 2d 82) were equally in error in arguing that the amount of the gift did not include the luxury wartime excise tax.

But, suppose our thoughtful husband bought the car for himself in 1965 and drove it the seven years prior to his death in 1972. By then it would be properly valued as a $400.00 piece of junk.

Yet, if the car were to be valued in his estate under the "cost of comparable contracts at the attained age of the insured" formula of Reg. Sec. 20.2031-2 (h), *i.e.* as the price of a brand-new single premium life insurance policy on the life of another is held to be the value of the policy owned by the estate, it would be taxed in the gross estate at the $7,200.00 price tag of a 1972 Buick Electra.

The Commissioner claims this was what the Supreme Court meant by its decision in the *Guggenheim* case. It quite surely did not.

The fact of the matter was that the Commissioner issued the Estate Tax regulation to use the "reasonable versus unreasonable" argument to confuse the issues in the *Estate of Richard DuPont* just as he did in the *Wells* case (*supra*).

Richard DuPont's Estate included five single premium life insurance policies on his father's life and an interest in a trust owning 17 additional policies. Just as in the *Wells* case, the executor argued that the cash surrender value was all they were worth to the Estate. The Tax Court sided with the Commissioner. *Estate of Richard C. DuPont v. C.I.R.*, 18 TC 1134.

The executor might still have had a fighting chance in the Third Circuit Court of Appeals, but, just as in this case,

the Commissioner used his power to issue regulations to make the DuPont Estate jump one more hurdle. He amended the Estate Tax Regulations to specify that "the value (in an estate) of . . . an insurance policy on the life of a person other than the decedent, issued by a company regularly engaged in the selling of contracts of that character is established through the sale by that company of comparable contracts". This regulation was issued on May 27, 1952, while the Tax Court was still deliberating its decision. T. D. 5906, 1952-1 C. B. 155.

To remove any doubt that the new rule applied to DuPont's Estate, it was made retroactive to estates of decedents dying before January 1, 1952 (Subparagraph (j), page 158).

Therefore, the principal question considered by the Third Circuit Court of Appeals was the "reasonableness versus the unreasonableness" of the Commissioner's regulation. *DuPont's Estate v. Commissioner*, 233 F. 2d 210 (1956), certiorari denied 352 U. S. 878.

Though the Court recognized in its opinion that the actual value, as a practical matter, might be more or less than the cash surrender value, depending upon the age and state of health of the insured, thus recognizing the existence of other relevant factors, it nevertheless held for the government on the premises that the Commissioner had not been completely unreasonable in issuing the regulation.

Having successfully used the *Guggenheim* case to win the *DuPont* case, the Commissioner decided to use the same technique in an effort to win the mutual fund issue.[8]

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[8] This is not an isolated illustration of the use of "quasi-legislation by regulation" as a bulldozer to clear the path for the Commissioner. Many Courts have had occasion to be critical of his arbitrary use of

(Footnote continued on following page)

C. The "entire bundle of rights" argument (Br. p. 16).

The Government's brief also cleverly paraphrases the "Bundle of Rights" language of the Guggenheim case in an effort to subtly identify mutual funds shares with single premium life insurance policies and, by inference, with his replacement cost theory.

The inference is that the public offering price somehow represents a special value that investors attach to mutual funds shares that they do not attach to their other stock investments.

The Securities & Exchange Commission reported exactly the opposite to Congress:

> "For most investors the sales charges for buying mutual fund shares are considerably higher than charges for buying and selling other types of securities. These higher costs do not pay for and are altogether unrelated to either the professional investment management or the portfolio diversification that the funds supply. No-load funds and closed-end investment companies furnish the same professionally managed, diversified portfolio as load funds do; yet no-load fund shares are available without the sales charges that investors pay when they buy load fund shares, and the sales charges on closed-end shares are those generally applicable to transactions in listed or

(Footnote continued from preceding page)
self-serving determinations to shape or change the law instead of interpreting it.

Cumulative evidence of this may be found in *Kurzner v. U. S.*, 413 F. 2d 97 (CCA-5, 1969); *Gamman v. C. I. R.*, 46 T. C. 1 (1966); *Sinnett v. C. I. R.*, 54 T. C. 231 (1970), *Amory Cotton Oil Co. v. U. S.*, and *Shores Realty Co., Inc. v. U. S.*, 72-2 USTC 9714 and 9715 (CCA-5, 1972); *Commissioner v. Shattuck*, 97 F. 2d 790 (CCA-7, 1938), *Commissioner v. Clark*, 202 F. 2d 94 (CCA-7, 1953); *United States v. Empey*, 406 F. 2d 157 (CCA-10, 1969); *LaForge v. C. I. R.*, 434 F. 2d 370 (CCA-2, 1970). For a tax practitioner's viewpoint see, for example, "A Critical View of the Treasury" in NYU Annual Institute on Federal Taxation, Vol. 15, pages 21-40.

over-the-counter securities, Managerial expertise and portfolio diversification are paid for by other charges which are of a continuing nature—an annual advisory fee and brokerage commissions. The sales load—paid at the time of purchase—is purely a payment for selling effort."

S. E. C. Report on the Public Policy Implications of Investment Company Growth, House Report No. 2337, 89th Cong., 2d Sess. 214-215 (1966).

Justice Tannenwald's dissenting opinion in *Frances Foster Wells v. Commissioner*, 50 TC 871, 879, correctly analyzes the bundle of rights argument:

"The emphasis by the majority on the fact that the estate and the beneficiaries may continue to own the mutual fund shares and thereby enjoy the benefits of ownership is, in my opinion, wholly misplaced. These possibilities exist with respect to every type of security. If the majority standard is correct, it would be no less 'appropriate' to use replacement cost with respect to marketable securities of all kinds. This, however is simply not the law."

D. The "no hardship" argument (Br. pp. 17-18).

The Tax Court used an irrelevant argument in *Wells v. Commissioner*, 50 TC 871, 877, saying that, after all, the estate or the heirs might be able to get part of the estate tax back as an administration expense or on a subsequent sale. The government's brief uses this same apology, citing Reg. Sec. 20.2053-3(d)(2).

The reference is to the capital loss the executor would realize if he sold instead of distributing the shares in kind and the capital loss the heirs would realize if they later sold them for their own account.

What both omitted to explain is that:

1. A deduction of this capital loss as an expense of administration is allowed only if the sale was *necessary to pay debts, etc.* Reg. Sec. 20.2053-3. This condition is also noted in the Tax Coordinator published by Research Institute of America in paragraph R-6016.5 on page 46,118A as follows:

> "If property is in fact sold or redeemed to a *dealer* for less than its fair market value, then the 'loss' (value over price paid by dealer) is deductible *as an administration expense.* The net practical effect is to wash out the higher fair market value included in the gross estate by an offsetting deduction *if* sold to a dealer. But for this rule to apply, the sale must be necessary in order to pay the decedent's debts and expenses of administration or taxes, to preserve the estate or effect distribution." (Emphasis supplied)

If Mrs. Bennett's executor had sold them, he could not have claimed the loss because the sale would not have been *necessary* under the regulations.

2. The Commissioner's amendment to Reg. Sec. 20.2053-3 by TD 6826, 1965-2 CB 367, is wholly illegal and invalid and completely outside the scope of his authority. The loss on the sale of a mutual fund share, like the loss on the sale of any other stock, is a capital loss. The loss on the sale of a private automobile is a non-deductible capital loss. § 2054 of the Code limits the deduction of losses to fires, storms, shipwrecks and other casualties. The Commissioner has no right to add additional classes of losses to § 2054. He has even less right to disguise them as administration expenses and allow them under § 2053. The amendment is clearly invalid.

The "higher basis for capital gain or loss purposes" argument is subject to the same criticism. It is valueless to beneficiaries who elect to keep their shares subject to another estate tax at the same fictitious value. Furthermore, only one-half of the "load" would be taken into account in determining the capital gain or loss resulting from a subsequent sale, if any were sold (Form 1040, Schedule D).

Judge Curtin was right when he said " . . . If the regulation setting fair market value is unreasonable, this unreasonableness cannot be cured by a regulation which limits the hardship imposed upon a taxpayer." 323 F. Supp. 769.

He might well have added that TD 6826, 1965-2 CB 367 is only further proof of the violence the Commissioner is doing to the statutes he is supposed only to interpret, because of his recent plunge for the replacement cost theory of valuation.

E. The "price the public pays in the retail market" argument (Br. p. 11).

The government's brief calls the Court's attention to Reg. Sec. 20.2031-1(b) as though the three sentences added to the regulation by T. D. 6826, 1965-2 CB 367 (quoted on page 31) were precedent for the mutual fund regulation when, in fact, they were not added to the general valuation section for more than a year and a half after the mutual fund regulation was issued.

The Commissioner is not being completely candid. The cross reference to mutual fund shares and single premium life insurance policies on the life of another in the last sentence (the reference to Reg. Sec. 20.2031-8) was to lay the foundation for a claim that he was not completely without precedent in valuing automobiles and household furniture

at "replacement cost" or "retail". Now, turning it around, he claims it shows he was not without precedent for valuing mutual fund shares at replacement cost.

The Court is respectfully referred to Point II, C (*supra*) for the respondent's discussion of this clearcut misinterpretation of the statute.

F. The "new underwriting" argument (Footnote, Br. p. 11).

The attempted analogy between a new underwriting in which the issuer does not guarantee to repurchase the shares at any price and the sale of mutual fund shares with a guaranteed redemption price is superficial. Perhaps that is why it has been relegated to a footnote. It ignores two important differences.

1. The subscriber to a share of a new underwriting, say, at the $100 offering price can sell it the same day at $100, perhaps more, because the "fair market value is determined by the law of supply and demand after the issuance" (R. 66-68). But, the purchaser of a share of a mutual fund for, say, $108 can sell it the same day *only* for its redemption price of $100. If Mr. Cartwright had purchased as many additional shares as the decedent owned for $133,325 on the day of her death, they too would have been worth only their redemption value of $124,399.

2. We are not concerned here with the value as of the date of purchase. Instead we are concerned with the value, as of the date of Mrs. Bennett's death, of shares which had been purchased by her deceased husband many years before. The original cost to him becomes a matter of historical unimportance and the commission he paid had long since ceased to be a "component element of value", if it ever was.

G. The "new legislation" argument (Footnote, Br. p. 22).

The legislation pending before Congress reflects unfavorably on the Commissioner's action.

A more reasonable interpretation of the situation is that it reflects some consensus of opinion that the regulation is basically unfair and unreasonable; it is some evidence that the Commissioner has again abused his regulatory powers and has in fact legislated in this area; so that Congressional legislation is necessary to undo or "repeal" Reg. Sec. 20.2031-8(b).

H. The Ruehlman and Howell cases.

Judge Hauk, in *Robert C. Davis v. United States*, 306 F. Supp. 949, affirmed 460 F. 2d 769 (CCA-9, 1972) characterized the reasoning in the *Ruehlmann* and *Howell* cases as "logical infirmities and unrealistic conclusions serving only to strengthen his conviction that the only true actual realistic value was the redemption price."

Interestingly enough, the government seems to have abandoned the major reasons given by the Tax Court and the Sixth and Seventh Circuit Courts of Appeal for refusing to find the regulation completely unreasonable.

Even though the government does not stress these arguments, the Court might appreciate a brief commentary on them as follows:

The "different breed of cats" argument.

Any contention by the Commissioner that mutual fund shares are "kissin' kin" of insurance policies would have to be suspect when:

1. The Internal Revenue Service requires executors to report them in federal estate tax returns (Form 706) in Schedule B entitled "Stocks and Bonds".

2. The mutual fund regulation appears among the instructions for reporting "Stocks and Bonds" in Schedule B and has never been included in Schedule D (Insurance) (Form 706).

3. The Internal Revenue Service requires taxpayers to report the dividends and capital gains distributions from mutual fund shares in Schedule B, Part I, entitled "Gross Dividends and Other Distributions on Stock" (Form 1040 and the instruction booklet).

4. Congress assigned the jurisdiction over regulated investment companies to the Securities and Exchange Commission, etc., etc., etc.

The "bid price is not a willing buyer-willing seller price" argument.

The Seventh Circuit in *Howell v. United States* (supra) was under the misapprehension that the investment company sold them at the asked price and redeemed them at the bid price and that it was thus "impossible to match a willing buyer and a willing seller". If it were impossible for buyers and sellers to agree on a price, one would rightfully wonder how any sales were ever made. So, it is quite understandable why the petitioner has abandoned this line of reasoning.

The "required by law" argument.

It also noted the "required by law" argument used by the Sixth Circuit Court of Appeals in the *Ruehlmann* case; that the investment company was not a willing purchaser at the redemption price.

Because this is incorrect, positive evidence was developed in this case that each of the three Investors Companies

voluntarily elected to be open-end investment companies with redeemable shares; that this election was made in their certificates of incorporation prior to registration with the SEC (R. 76-77); that they had to be incorporated before registering with the SEC (15 USC § 80A-8) and that these Investors Companies consider it advantageous for sound and realistic business reasons to willingly offer and to stand ready, willing and able at all times to redeem any shares presented to them. The promise of immediate and guaranteed liquidity is an extremely important and integral part of making a sale (R. 49-52). They compete effectively with securities on the exchanges by promising to redeem shares "upon receipt of the certificates and pay for them within seven business days" (R. 52).

In the face of such clear-cut documentary evidence and expert testimony in the record of this case, the petitioner has quite correctly abandoned this argument too.

I. Fallacies in petitioner's brief.

The petitioner uses a number of devious and subliminal techniques in an effort to portray a horse chestnut as a chestnut horse including clever phrasing to disguise non-sequiturs and make contradictions appear compatible, supporting one faulty argument with another and stating, as accepted or proven facts, those which have been disproven. For example, in the Orwellian view of the petitioner:

1. The mutual fund regulation must be sound because he has already decided under his automobile regulation, Reg. Sec. 20.2031-1(b)—which he has has been afraid to enforce—that his widow should have to pay the estate tax on $4,200.00 even though she can get only $3,400.00 for his secondhand Cadillac (Br. p. 11).

2. It would be wrong, when shares are subject to a contract or option to purchase, to value them at price higher than the contract or option price. Therefore, mutual funds should be valued at more than the estate can get for them (Br. pp. 20-21).

3. It is an advantage for the estate to "incur the hardship" of paying estate taxes on the load so it can get an "administrative expense deduction" useable only if it is absolutely necessary to sell the shares to pay debts, taxes or effect distribution (Br. pp. 6-7).

4. There is really an advantage to be gained by paying the 100% estate tax on the load so that the beneficiary can "enjoy the benefit" of the 50% income tax deduction at the capital gains rate (Br. pp. 6-7).

5. Sales at the public offering price are the "only market in which shares are commonly sold" (Br. pp. 10-11) (yet, in Footnote 4, page 3, informs the Court that "sales back" to the companies at the bid price aggregate many millions of shares each year. It is also a known fact that during a substantial part of 1972 "sales back" exceeded "sales by" by many millions of shares with a substantial adverse impact on the industry).

Conclusion

For over 22 years mutual fund shares were valued in the same manner as other securities. The Commissioner now seeks to upset this long-settled rule by means of a regulation so totally at variance with existing methods of valuing securities that he is ashamed to put it in the same section with them. This regulation would tax mutual funds at a value which the estate could never realize under any circumstances.

This is a flagrant example of bureaucratic legislation which recalls the words of Mr. Justice Douglas in *Commissioner v. Lester*, 366 U. S. 312:

> "Resort to litigation rather than to Congress, for a change in the law, is too often the temptation of government which has a longer purse and more endurance than any taxpayer."

The decision of the Court below should be affirmed.

Respectfully submitted,

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Conclusion

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The valuation of mutual fund shares for Estate Tax purposes at the public offering price (which includes the sales commission) instead of net asset value (the amount actually realizable on redemption by the investor or estate) applies the "willing buyer-willing seller test" in an unreasonable manner, which ignores the effect of relevant provisions of the 1940 Act, the realities of industry practice and the understanding of the parties and unfairly analogizes the sale of fund shares to single payment life insurance policies instead of corporate stock or similar investment securities 8

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1972

No. 71-1665

UNITED STATES OF AMERICA,

Petitioner,

—v.—

DOUGLAS B. CARTWRIGHT, as Executor of the Estate of ETHEL B. BENNETT.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE INVESTMENT COMPANY INSTITUTE AS *AMICUS CURIAE*

Opinions Below

The opinion of the court of appeals is reported at 457 F.2d 567 and the opinion of the district court at 323 F. Supp. 769.

Question Presented

Whether Section 20.2031-8(b) (1963) of the Treasury Regulations on Estate Tax (1954), which requires that shares of open-end investment companies (mutual funds) should be valued for estate tax purposes at the public

offering or asked price (which includes an 8% sales commission), instead of at net asset value (the bid price or the amount actually paid by the fund to the investor or his estate on redemption) is a reasonable regulation.

Statutes and Rules Involved

In addition to the pertinent provisions of the Internal Revenue Code of 1954 and the Treasury Regulations on Estate Tax thereunder, set forth in Petitioner's Appendix* (Pet. Br. pp. 23-27), we set out in the ICI Appendix *infra*, pp. 27-37, pertinent provisions of the Investment Company Act of 1940, c.686, 54 Stat. 789 as amended, 15 U.S.C. 80a-1, et seq. and related Rules.

Statement

The Government appeals from a decision of the court of appeals, affirming the district court's finding that Section 20.2031-8(b), of the Treasury Regulations on Estate Tax, which requires that shares of an open-end investment company (mutual fund) be valued for estate tax purposes at the public offering (asked) price (i.e., net asset value plus sales commission), instead of at net asset value or bid price (the price actually paid on redemption by the fund to the estate), is invalid.

The Government argued that the challenged regulation is in accord with general principles of valuation contained in Sec. 20.2031-1(b) of the Regulations which states that

* References to Appendices are hereinafter designated as follows: Joint Appendix (J.A.); and Investment Company Institute Appendix (ICI App.). Petitioner's brief is designated Pet. Br.

"fair market value is the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell . . ." and that therefore the replacement cost of the fund shares ("public offering price")—including the sales commission (or "load")—are properly included in the value of these shares for estate tax purposes under the provisions of Sec. 20.2031-8(b).

As justification for the Regulation, the Government analogized the valuation of mutual fund shares to the method of valuation of single payment life insurance policies approved by this Court in *Guggenheim* v. *Rasquin*, 312 U.S. 254. It is argued that mutual fund shares have a value beyond their redemption price, which is reasonably reflected in the added commission charge. The Government claims its regulation is reasonable and must, therefore, be accepted by the courts, despite the existence of other alternative methods of valuation. *United States* v. *Correll*, 389 U.S. 299, 306-307.

The court of appeals and the district court found the regulation unreasonable and the Government's analogy to single payment life inapposite. They found that the Government's theory of valuation did not accord with the way in which fund shares are actually bought and redeemed, especially the important role of guaranteed redemption at any time by the fund at the then current net asset value. Both courts held the addition to the redemption price of a commission charge and the assignment of a value for estate tax purposes in the amount of the commission over and above the redemption price, a value which the estate can never realize in any market and which was never a part

of the net assets of the fund, was an invalid exercise of power.

The court of appeals emphasized the principle of valuation included in Sec. 20.2031-1(b) that "All relevant facts and elements of value as of the applicable valuation date shall be considered in every case."

The court concluded:

> We would agree . . . that the retail sales price of a property unit may be an important factor in the determination of its fair market value; yet it is also clear that other factors can affect the price which a willing seller reasonably could expect to receive from a sale of that particular unit, and if these other factors cause the retail price to be an unreasonable or unrealistic value standard, the retail price has not always been followed in valuation disputes as the sole criterion of value. (457 F.2d at 571) (footnote omitted).

Neither the realities of the mutual fund business nor the scheme of regulation under which it functions support the Government position.

The pattern of regulation under the Investment Company Act, c. 686, 54 Stat. 789 (15 U.S.C. 80a-1 et seq.) ("1940 Act" or "Act"), especially the provisions for redemption under Section 22(e) (15 U.S.C. Sec. 80a-22) and related provisions of the Act, fully support the conclusions of the courts below that it would be unreasonable to include the commission (or sales "load"), charged for the acquisition of fund shares, as a part of the value of those shares for estate tax purposes.

Interest of the Investment Company Institute as *Amicus Curiae*

The Investment Company Institute includes in its membership 378 open-end investment companies (mutual funds) registered under the 1940 Act, accounting for approximately 90% of the industry's assets and 8.5 million shareholders.

The position of the Government imposes an additional tax burden on the millions of mutual fund shareholders who will leave fund shares as part of their estates. It imposes a tax penalty unanticipated by Congress, fund distributors or investors who bought fund shares for investment and retirement purposes.

The addition of the sales commission charge to the redemption (net asset) value for estate tax purposes creates an artificial incentive to early redemption while the investor is alive, and is therefore harmful to the best interests of fund shareholders.

The Government's position unfairly discriminates against funds charging sales commissions (load funds) and favors no-load funds, closed-end funds and individual stocks and bonds as investment vehicles. It makes mutual funds a less attractive investment and disadvantages fund investors.

The national public policy as expressed by the 1940 Act is to provide a well regulated industry for the management of investors' money.

The Securities & Exchange Commission itself has recognized

> . . . the fact that by offering the American public a medium for professionally managed investment in se-

> curities, primarily the stocks of America's leading companies, the investment company industry, and specifically mutual funds, fulfill an important public need. The industry has earned its place as an important component of our Nation's financial community.[1]

The Investment Company Institute here seeks to avoid the imposition of an unfair and arbitrary tax burden on mutual fund shareholders and the elimination of an unwarranted and significant discrimination in estate tax treatment against mutual funds sold through distributors charging sales commissions.

Summary of Argument

1. Mutual fund shares are by statutory definition "redeemable" (Sections 2(a)(32), 22(e), 1940 Act) and that Act requires that funds stand ready to redeem their outstanding shares at the request of any shareholder. Such redemption is made at the then current net asset value, which does not include any sales commission. (Section 2(a)(32)). The only practical way for a shareholder to redeem is to tender his shares to the fund. Commission (sales) charges on the purchase of fund shares are fixed and paid to the sales organization when the shares are purchased. (Section 22(d)). The sales commission is never a part of the fund's net assets.

2. The Government seeks to value fund shares for Estate Tax purposes, under Section 20.2031-8(b) of the Treasury Regulations, at the public offering price, i.e. the net asset value *plus* sales commission. The Government's posi-

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[1] SEC, *Report on Public Policy Implications of Investment Company Growth*, H. Rep. No. 2337, 89th Cong., 2d Sess. (1966), letter of transmittal of Chairman Cohen, at p. vii ("SEC PPI Report").

tion, that the value of such shares should include sales commission is based on "replacement value". Since a shareholder seeking to purchase such shares would have to pay the public offering price, which includes a commission, the Government argues that the offering price is the correct value of the shares. This view is contrary to the regulations applied to the valuation of other corporate stock, including listed and unlisted stock, closed-end investment companies and no-load mutual funds. No reasonable basis exists for such a distinction either in the regulatory scheme or the realities of the market.

3. The Government's analogy to single payment life insurance (citing *Guggenheim* v. *Rasquin*, 312 U.S. 254) is wholly inappropriate. Mutual funds are clearly unlike life insurance policies (*SEC* v. *Variable Annuity Co.*, 359 U.S. 65) and should be valued instead like other shares of corporate stock, not life insurance policies to which they bear no legal or realistic resemblance. Analogy to the new issuance of stock offered to the public through an underwriter, before a trading market has been established, is similarly without reasonable basis, as the SEC's 1966 mutual fund study (SEC PPI Report, *supra*, note 1) makes clear. Every reasonably analogous valuation situation demonstrates that the Government is unfairly singling out mutual fund shares sold through brokers or sales organizations for discriminatory treatment which disadvantages fund shareholders in determining value for Estate Tax purposes.

4. Even the application of the willing buyer-willing seller standard does not support the Government's view since the initial purchase agreement, made between the fund as a willing seller and the purchasing shareholder as a willing buyer, includes the right to redeem at net asset value at any time the shareholder wishes to do so.

ARGUMENT

The valuation of mutual fund shares for Estate Tax purposes at the public offering price (which includes the sales commission) instead of net asset value (the amount actually realizable on redemption by the investor or estate) applies the "willing buyer-willing seller test" in an unreasonable manner, which ignores the effect of relevant provisions of the 1940 Act, the realities of industry practice and the understanding of the parties and unfairly analogizes the sale of fund shares to single payment life insurance policies instead of corporate stock or similar investment securities.

A. *Introduction: The 1940 Act and the Regulatory Pattern, Industry Practice and the Expectation of Investors*

The two unique aspects of mutual funds that distinguish them from other investment media and have "substantially contributed to the growth of the industry . . . are the redeemability of mutual fund shares and their continuous offering to the public." [2]

In considering the issues involved in this case it is important to set out the regulatory scheme which defines the terms and sets the standards under which the mutual fund industry operates. An investment company is defined by the 1940 Act as one in which a number of investors have pooled their resources to engage in the business of investing, reinvesting or trading in securities.[3] The Act

[2] Securities and Exchange Commission, Special Study of Securities Markets, Ch. XI, Open-End Investment Companies, H. Doc. No. 95, Pt. 4, 88th Cong., 1st Sess., at 95-96 (1963) ("Special Study").

[3] Sections 3(a)(1)-(3).

then classifies the various types of investment companies; the most important grouping in terms of size and number of investors is the management companies.[4] Management companies are in turn divided into closed-end and open-end companies, the latter are generally known as mutual funds.[5] A mutual fund is defined as one that "is offering for sale or has outstanding any *redeemable security* of which it is the issuer."[6] Section 2(a)(32) defines "redeemable security" as any security under the terms of which the holder may present it to the issuer and be entitled to receive "his proportionate share of the issuer's current net assets, or the cash equivalent thereof."

Mutual funds are required by Section 22(e) of the Act, as well as their underwriting agreements and corporate charters to be continuously ready to redeem their outstanding shares upon tender by any shareholder.[7]

The Special Study explained the basic manner in which mutual fund shares are sold:

> Mutual fund shares are not traded on exchanges or generally in the over-the-counter market, as are other

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[4] See Section 4.

[5] Section 5.

[6] Section 5(a)(1). (Emphasis added.)

[7] Section 22(e) prohibits a registered mutual fund from suspending the right of redemption or postponing payment for more than seven days after the tender, except in the case of certain emergencies. The Stipulation of Facts in this case states: "12. As stated in each prospectus, the certificate of incorporation of each of these investment companies gives each registered shareholder the right to require the investment company to redeem his shares at any time at the redemption price described in the prospectus. Although there are no restrictions on the transferability of shares of these investment companies, the shareholders ordinarily dispose of them by requesting the company to redeem them" (J.A. 25).

securities, but are sold by the fund through a principal underwriter, and redeemed by the fund, at prices which are related to "net asset value." The net asset value per share is normally computed twice daily by taking the market value at the time of all portfolio securities, adding the value of other assets and subtracting liabilities, and dividing the result by the number of shares outstanding. Shares of most funds are sold for a price equal to their net asset value plus a sales charge or commission, commonly referred to as the "sales load," and usually ranging from 7.5 to 8.5 percent of the amount paid, or 8.1 to 9.3 percent of the amount invested. A few funds, however, known as "no-load" funds, offer their shares for sale at net asset value without a sales charge. Shares of most funds are redeemed or repurchased by the funds at their net asset value, although a few funds charge a small redemption fee. The result of this pricing system, it is apparent, is that the entire cost of selling fund shares is generally borne exclusively by the purchaser of new shares and not by the fund itself. In this respect the offering of mutual fund shares differs from, say, the offering of new shares by a closed-end investment company or an additional offering "at the market" of shares of an exchange-listed security, where at least a portion of the selling cost is borne by the company selling the shares.[6]

Fund shares are sold to the public through principal underwriters pursuant to underwriting contracts with the

[6] Special Study, *supra*, at 96-97 (footnote omitted); see also, SEC PPI Report, *supra*, at 41-43, 51-56.

funds[9] (as Investors Diversified Services ("IDS") has in this case); these underwriters receive the entire commission (or load) on sales and retain it or reallow a portion to fund salesmen or brokers, depending on whether their sales force is fully integrated (or "captive") (as is the situation in IDS) or whether shares are sold through independent brokers. (See description, Special Study, Ch. XI, *supra*, at 102-107.) As the Special Study points out, the load goes to the sales organization, not to the fund. It never becomes a part of the fund's net assets. (*Id.* at 96-97, 107-9.)

The sales organizations must sell to the public at the predetermined public offering price, that is net asset value plus a set commission or load which is fixed for each fund. The level of commission is fixed pursuant to Section 22(d) of the Act, which in effect provides for retail price maintenance in the sale of fund shares. Thus, the sales price of fund shares is not negotiated. The net asset value is determined daily by dividing the value of the stock and other assets in its portfolio by the number of shares outstanding; the fixed sales commission is added to that price. Section 22(b) of the 1940 Act also authorizes the National Association of Securities Dealers (NASD) to prohibit its members from purchasing fund shares from any mutual fund or its principal underwriter at any price other than the public offering price, less a discount (computed under its rules). The NASD forbids the sale of fund shares by principal underwriters at a discount from the public offering price to anyone other than a dealer who is an NASD member, and then only pursuant to an existing sales agreement set-

[9] Section 15(a)-(c) imposes certain requirements respecting these contracts including approval by the board of the fund and termination provisions.

ting forth the concession.[10] The sales agreements provide that the selling dealer must sell at net asset value plus the fixed sales charge and no less.[11] Rule 2a-4 under the 1940 Act (ICI App. pp. 34-35) defines "current net asset value" for use in computing the current price of a redeemable security.

In sum, the essential conditions of the sale of mutual fund shares are controlled under the 1940 Act, which requires that fund shares be sold, pursuant to selling agreements with principal underwriters,[12] who act as agents for the fund and receive a fixed percentage of the selling price as their commission (Section 22(d)). Such commissions do not become part of the fund's assets.[13] The Act requires (Section 22(e)) and its prospectus represents that the fund stands ready (through its underwriter) to redeem shares at net asset value (as defined under the Act) and that this contractual right is protected by federal law. The fund cannot redeem at any price more than net asset value or the remaining shareholders would be illegally diluted. (Sec. 2(a)(32)). Redemptions are almost always accomplished by tendering to the fund or through its agent.[14]

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[10] NASD Rules of Fair Practice, Art. III, Section 26(c) (ICI App., pp. 36-37). See discussion in Special Study at pp. 98-99.

[11] Special Study, at 98.

[12] Section 15(a)-(c).

[13] The sales commission should be clearly distinguished from the management (or advisory) fee which is usually approximately .5% annually, which is periodically paid out from the fund directly to the fund's manager (or adviser) pursuant to a management contract between the manager (or adviser) and the fund pursuant to Section 15 of the Act.

[14] See SEC PPI Report, p. 42.

B. *The Initial Purchase Agreement, Made Between the Investor as a Willing Buyer and the Fund, Through Its Underwriter, as a Willing Seller, Includes the Right of Redemption*

The Government argues that the only time that the willing buyer-willing seller situation exists in the sale of fund shares is at the time of the original sale. (323 F. Supp. at 772) (See Pet. Br. 10-11). The redemption, it is argued, is under compulsion or obligation and thus, not willing on the part of the fund. The argument misconceives a basic element in the sale of fund shares—that *at the time of purchase* the investor and the fund agree, without compulsion, that the investor (or his estate) can at his option redeem his shares at net asset value at any time in the future. The Stipulation of Facts in this case (see note 7, *supra*) specifically recognizes that, "as stated in each prospectus, the certificate of incorporation . . . gives each . . . shareholder the right to require the investment company to redeem his shares at any time at the redemption price described in the prospectus" (J.A. 25). Thus, the redemption feature is built into the fund shares from the beginning and it is unrealistic to picture the fund as an *unwilling* purchaser at the time of redemption. This segmented reasoning neither comports with the provisions of the 1940 Act, the undertakings of the parties nor the reality of fund sales operations (J.A. 50). The district court correctly found that:

> . . . at the time of original purchase, the buyer is fully aware that, at the time of sale back to the company, he will be able to sell the shares back at the net asset value or redemption price, whatever it may be at that time. At the time of original purchase, both the buyer

and seller are fully cognizant of the facts and willingly enter into the transaction (323 F. Supp. 772).[18]

Thus, even under the willing buyer-willing seller test, the value to the estate should be net asset value because the redemption is the result of a sale made by a willing buyer to a willing seller, which sale included the right to redeem at any time at net asset value. The investor can, as a practical matter sell his shares only to the fund at a price that is not open to speculation, but is specifically calculated under the 1940 Act to reflect the true value of the shares.

The court of appeals correctly referred to the "strikingly similar" situation where Treasury Regulation 20.2031-2(h) requires that the value of shares of corporate stock subject to a restrictive agreement that they cannot be sold unless first offered to the corporation itself (or to another) at a specific price, if agreed upon in an arm's length transaction, is the price so specified and not the public market price available on an exchange (457 F.2d at 571).

Certainly, the mutual fund purchase agreement, which includes not only a contractual agreement to redeem (sell the shares back to the corporation) at the investor's option, but a statutory obligation to do so, at a specific price (then existing net asset value), is clearly within the reasoning

[18] Similarly, in *Davis* v. *United States*, 460 F.2d 769, 772 (CA 9, 1972) the court of appeals stated:

> . . . As a practical matter for determining value, however, the redemption market is the market upon which both parties agree when the shares are purchased. The mutual fund chooses to operate in such form under the law and the public buys shares in the fund fully apprised of its redemption opportunities through company prospectuses.

which applies to such restrictive agreements to resell to a corporation.[16]

C. The Rejection of Valuation of Single Payment Life Insurance at Cash Surrender Value in Guggenheim v. Rasquin, *312 U.S. 254, Does Not Control Valuation in the Case of Mutual Fund Shares*

The decision in *Guggenheim, supra,* relating to the value of a single payment life policy should not control here. In that case this Court held the payment of $852,438 for a fully paid life policy, with a face value of $1 million, could not be realistically valued at the cash surrender value of $717,344. The rule in *Guggenheim* would in no way be undercut by a ruling that mutual fund shares should be valued at their redemption (bid) value rather than at the redemption price plus sales commission (asked).

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[16] The district court in *Davis* v. *United States*, 306 F. Supp. 949, 955 (C.D. Cal., 1969), *aff'd*, 460 F.2d 769 (CA 9, 1972) commented:

> Although there is no binding contract in this case, the rationale of Treas. Reg. 20.2031-2(h) (1958) should apply to the open-end investment shares because the redemption price offered by the company truly represents the only realistic value that the estate can obtain for the shares of the open-end investment company. Cited with approval by the court of appeals herein, 457 F.2d at 571, n. 7.

It is not at all clear that no binding contract exists in the fund situation. An investor would clearly have a cause of action under Sec. 22(e) of the 1940 Act as well as under the charter and prospectus representations of the fund if redemption were refused. See cases upholding private rights of action for violations of other Sections of the 1940 Act. *Brown* v. *Bullock*, 194 F. Supp. 207 (SDNY), *aff'd*, 294 F.2d 415 (CA 2, 1961); *Levitt* v. *Johnson*, 334 F.2d 815 (CA 1, 1964), *cert. denied*, 379 U.S. 961 (1965); *Chabot* v. *Empire Trust Co.*, 301 F.2d 458 (CA 2, 1962); as well as other provisions of the federal securities laws. E.g., *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 432 (1963); *Sup't of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6 (1971).

The inappropriateness of the single payment life analogy was fully discussed by the courts below (323 F. Supp. at 772-73, 457 F.2d at 570-71; and in *Davis* v. *United States*, 306 F. Supp. at 956; 460 F.2d at 772).

This Court in *Guggenheim* pointed out that "the owner of a fully paid life insurance policy has more than the mere right to surrender it; he has the right to retain it for its investment virtues and to receive the face amount of the policy on the insured's death." 312 U.S. at 257.

The court of appeals in *Davis, supra,* concluded:

> Had the insured died the day after issue, the policy would have matured at $1,000,000. Based on actuarial tables, its cash surrender value was considerably less. Along with this value uncertainty were other values likewise imprecise. We cannot equate the valuation of shares in a mutual fund with the necessarily abstract valuation of a single premium life insurance policy. On any given day, the net value of the mutual fund shares may be computed exactly (460 F.2d at 772).

The Government argues (Pet. Br. 16-19) that mutual fund shares are more like life insurance policies than shares of corporate stock, whose value for estate tax purposes does not under Section 20.2031-2(b) include the broker's commission necessary to purchase these securities through an exchange member or an over-the-counter broker. The Government acknowledges that listed stocks are valued under Section 20.2031-2 at the mean between the highest and lowest quotations on the date of death. *This value does not include the fixed commission charge imposed by all*

exchange member firms on the purchase or sale of listed securities. Inexplicably the Government argues that this "is entirely consistent with the regulation under attack here, because the quoted price of a listed stock, like the asked price of a mutual fund, is the amount which a willing buyer pays to a willing seller" (Pet. Br. 18). The Government seems to ignore in its determination of value of listed stock the fact that in both cases—listed stock and mutual fund shares—replacement of the shares in the estate by purchase on the market would require the payment of a fixed brokerage commission.[17]

It was argued below that the estate could continue to own the fund shares for investment purposes, including the possibility of receiving capital gains and dividend distributions. The court of appeals correctly observed that:

> This argument applies with equal force to the shares of numbers of corporations listed on the stock exchanges, not only to the mutual fund shares. Clearly, the com-

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[17] Thus, for stocks listed on the New York Stock Exchange (in purchases involving less than $300,000) this involves a fixed commission to the broker over and above the market or quoted price. See Constitution of the NYSE, Art. XV, Secs. 1, 2 and 7, discussed in Securities Industry Study, Report of the Subcommittee on Securities, Committee on Banking, Housing and Urban Affairs, U.S. Senate, Ch. III, pp. 53-56 (Feb. 4, 1972). Moreover, since brokers would also require payment of commissions to purchase or sell OTC stock, there is no real difference in substance from the situation involving listed securities (Pet. Br. 19 n. 14) and the same inconsistency appears. See, Special Study, *supra*, note 2, for a discussion of the operation of the stock exchange commission rate structure, Ch. VI, I., especially pp. 295-97 on non-member commissions and Ch. VII, A-D I, discussing the operation of the over-the-counter markets, especially pp. 624-27 on the costs of execution for retail customers. The implementation of volume discounts and negotiated rates above $300,000 in listed securities and the continued existence of negotiated commissions on OTC transactions does not alter the situation in the context of this case.

> missions paid to brokers when shares in these companies are bought or sold are not in payment for, or a measure of, the value beyond the resale price, but are rather simply compensation to the broker for his services. (457 F.2d at 570)[18]

Life insurance policies are clearly distinguishable for valuation (as well as basic regulatory) purposes from stocks and bonds traded on the exchanges and in the securities markets. That difference was recognized in *Guggenheim*, where this Court pointed out that:

> [A]n important element in the value of the property is the use to which it may be put. Certainly the petitioner here did not expend $852,438.50 to make an immediate gift limited to $717,344.81. Presumptively the value of these policies at the date of the gift was the amount which the insured had expended to acquire them. (312 U.S. at 257-58).

The question here is whether mutual fund shares should be treated like corporate stock or like life insurance policies. The important distinctions between life insurance and mutual funds have come before this court before. *SEC v. Variable Annuity Co.*, 359 U.S. 65 (1959) ("VALIC"); *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1967) ("United Benefit").[19] These cases make clear that insur-

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[18] Citing with approval the dissent of Judge Tannenwald in *Wells v. Commissioner*, 50 T.C. 871, 880 (1968) *aff'd* sub nom. *Ruehlmann v. Commissioner*, 418 F.2d 1302 (CA 6, 1969) *cert. denied*, 398 U.S. 950 (1970).

[19] See also: *Prudential Ins. Co. of America* v. *SEC*, 326 F.2d 383 (CA 3), *cert. denied*, 377 U.S. 953 (1964); hearings before the SEC, *In the Matter of American Life Convention, et al.* (File No. 4-149) (1972) (pending decision on rule making re variable life insurance and possible exemptions from the 1940 Act).

ance policies do not have the same characteristics as mutual fund shares and that investment companies, even when they are promoted as separate accounts by insurance companies, will not be permitted to escape regulation under the 1940 Act. If life insurance was really as similar to mutual funds as the Government seems to argue then the distinctions made in *VALIC* and *United Benefit* would not be meaningful. Whatever the problems when distinctions become blurred by remolding of the insurance product, it is certainly clear that mutual fund shares are not treated like true life insurance for substantive purposes, like federal regulation under the 1940 Act, that they have very distinct and separate characteristics and that in fact, mutual fund shares are, as the court of appeals found, more similar to corporate stock. (457 F.2d at 570-71). Fund shares are, after all, shares in an investment company, which (as in this case) is itself a corporation. Its value is determined by the performance of its portfolio securities and the value fluctuates from day to day. It has no fixed or guaranteed value. An investor may purchase mutual funds regardless of his health and at any age. There is no problem of eligibility such as that posed by uninsurability. As the district court noted in this connection:

> The bundle of rights in *Guggenheim* included the right to receive the face value of the policy at the time of death, and a certainty of insurance coverage if Mrs. Guggenheim became uninsurable.
>
> * * * * *
>
> No doubt there are advantages in holding mutual funds, but mutual funds and insurance policies are so different that the bundle of rights in each cannot be

> compared. . . . Because it is difficult for many individuals to obtain life insurance coverage, the purchase of a life insurance policy is a valuable right. There is no comparable consideration in the purchase of mutual fund shares. (323 F. Supp. at 773)[29]

Under the Government's view, shares in a closed-end investment company, whether listed on an exchange or not, are valued (as are corporate stocks) at the price the estate will realize on the sale of the shares, not what it would have to pay to replace the shares if bought through a broker (market price plus a brokerage commission). Shares of an open-end company, however, are valued at net asset value plus commission. Such disparate treatment is unreasonable; both entities are investment companies, the open-end fund has a precisely determinable market value and both kinds of shares normally involve fixed brokerage commissions. The closed-end shares are sold through the New York Stock Exchange (or over-the-counter if they are not listed) and would require payment of a commission to replace. The distinction in treatment imposed by the Government is not sound.

Similarly, and even more closely in point, a no-load fund bought by the same person would obviously be valued at net asset value, yet the bundle of rights in the hands of the investor (or the estate) is exactly the same in a no-load

[29] An examination of "the bundle of rights" involved in a single payment life policy as against the bundle involved in the purchase and ownership of mutual funds is certainly appropriate. See concurring opinion of Mr. Justice Brennan, in *VALIC*, 359 U.S. 77-80 and *SEC* v. *United Benefit Life Ins. Co.*, 387 U.S. 202, 205-209, 212. The courts below engaged in just such an analysis and correctly viewed mutual fund shares as more clearly analogous to corporate stock, not life insurance or annuities.

as in a load fund. The Government's interpretation advantages no-load investors over load fund investors in a way never contemplated by Congress. Such treatment merely demonstrates the aberrational results derived from application of the Government's interpretations. Certain no-load funds, as indicated by the record (J.A. 66), impose a 1% redemption charge. Presumably, not only would an estate holding such shares not be assessed a sales load of 8%, but would be entitled to deduct the 1% redemption fee. Moreover, some load funds have become no-load funds. (J.A. 57). Thus, a buyer of a load fund which later became no-load would be exempt from any additional "value" created by the existence of a load at the time it was bought. If some no load fund were to become a load fund then the Government would presumably assert that those who bought the shares at no load must include the new load for estate tax purposes. And that is, of course, directly analogous to the situation in this case, where the decedent acquired the shares by gift, inheritance and by purchase at the bid price by investment of dividends and capital gains at no-load. (322 F. Supp. at 771).

Further, following this logic, an owner of shares in a load fund could claim the net asset value *plus* the load as a charitable deduction, if the shares were contributed to a charity, since Section 1.170-1(c) (1) uses the same fair market value test as the estate tax provision here at issue.[11] The Government has yet to allow such a claim.

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[11] With respect to deductions for charitable contributions and gifts, Regulation 1.170-1(c) provides that "If a contribution is made in property other than money, the amount of the deduction is determined by the fair market value of the property at the time of contribution."

After stating the willing buyer-willing seller test, the Regulation continues "If the contribution is made in property of a type which the taxpayer sells in the course of his business, *the fair market value is the price which the taxpayer would have received if he had sold*

Also, if the no-load fund shares are bought through a broker who charges the normal commission charge (as some do) that is not considered as part of the shares' "value" for estate tax valuation purposes, but a load fund with no redemption charge has its load added as a component of its "value" to the estate.

The no-load situation again demonstrates the true nature of the fund investment. The only real distinction in terms of rights or obligations between load and no-load funds is the imposition of a sales charge for the load fund, a sales charge which the fund never sees. To impose this additional burden on load fund shareholders unfairly discriminates against them (as against shareholders in no load funds, closed-end investment companies, corporate stock and bond holders), without any reasonable basis, and is inconsistent with the treatment of stock valuation in other reasonably analogous situations.

In this connection, the Government seeks to analogize the instant situation to a new issuance of stock offered to the public through an underwriter, where the issuer receives the amount paid by the purchaser, less the underwriting spread or cost. (Pet. Br. 11, n. 8). The underwriting cost, it is pointed out, is reflected in the public offering

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the contributed property in the lowest usual market in which he customarily sells . . ." (Emphasis added.) The regulation does not state that the fair market value is the price which the taxpayer would have to pay to purchase similar property—(i.e., replacement value). Instead the regulation states that fair market value is the price which the taxpayer would receive if he were to sell it in the normal way in which that product is sold.

Since the normal and customary way in which the securities in question are "sold" by a taxpayer is through redemption, consistency with tax regulations concerning determination of fair market value in other situations requires that the price at which the taxpayer can sell his shares, and not their replacement cost, be viewed as the fair market value for estate tax purposes.

price, even though the issuer does not retain that cost. "If the shares of a new issue are required to be valued for tax purposes *before a trading market for the securities has been established* . . . it could hardly be argued that underwriting fees which are included in the public offering price should be eliminated in determining the fair market value of the securities." (*Ibid.*). (Emphasis added).

The analogy breaks down at the threshold because a market for the sale and redemption of the fund shares here in question has been established for many years. Although there is a continuous offering involved in the sale of fund shares, it cannot be reasonably said to resemble the situation in the over-the-counter market on the effective date of a new issue. The SEC in its 1966 mutual fund report specifically found that " . . . the distribution of fund shares bears little similarity to conventional underwritten offerings of equity securities."[22] (The SEC's Special Study made the same point. See quoted material, *supra*, p. 10).

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[22] Report of the SEC on Public Policy Implications of Investment Company Growth, H. Rep. No. 2337, 89th Cong., 2d Sess. (1966) at 213. More fully, the SEC's PPI Report states:

> Conventional underwritings involve the distribution of substantial blocks of securities within fixed and extremely limited time periods. The major portion of underwriting spreads is devoted to compensating members of underwriting groups for the intensive promotional and selling efforts required. Often the securities are being offered to the public for the first time, and the underwriters have to arouse investor interest in an unknown security. Even where the underwritten security is already known to the investing public, the underwriters must dispose of a block of securities which is extremely large in relation to normal trading volume within a relatively short period and in a manner which does not significantly depress the price in the trading markets. Toward this end they may risk their capital in attempting to stabilize the market price of the shares during the distribution.
>
> Underwriters also assume other risks. Not the least among these are reputation risks. If the post-distribution performance

The fact is, as we have noted, *supra*, pp. 16-17, that as soon as a trading market develops, corporate shares can be sold by the investor in the market only through a broker

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of the underwritten security is poor, the underwriters may lose customers. Underwriting group members run the risk that if they are unable to sell their allotment of shares, they may not be asked to join in subsequent underwritings.

Moreover, in firm commitment underwritings the underwriters are obligated to buy and to pay for the underwritten securities on a specified date, regardless of whether they are able to complete the distribution by that date. If the entire issue is not sold within the time limit, the underwriters must invest their own capital in the issue—sometimes for a considerable period. And if, subsequent to the termination of the underwritten distribution, they ultimately sell a portion of the issue at prices below those paid to the issuer, they may suffer a loss on the underwriting.

Underwriters do not assume this risk in underwritings conducted on a "best efforts" basis. In these, if the underwriters are unable to complete the distribution, they are not obligated to buy the underwritten securities from the seller. However, best efforts underwritings of conventional securities have little relevance to a comparison of underwriting spreads with mutual fund sales loads. Underwritings of seasoned securities—to which mutual fund shares compare in quality—are almost always on a firm commitment basis.

Small portions of underwriting spreads also compensate the investment bankers that manage the underwriting groups for selecting the securities for distribution from the various proposals presented to them, negotiating the terms and conditions of the offering with the sellers, investigating the issuers and organizing underwriting syndicates and selling groups of broker-dealers.

As noted in chapter II, distributions of mutual fund shares are classified for some purposes like conventional underwritings. Those who manage the distribution of fund shares are called "principal underwriters" and, like the spreads in conventional underwritings, mutual fund sales loads are expressed as a percentage of the offering prices rather than as a percentage of the amounts invested. Nevertheless, the distribution of fund shares bears little similarity to conventional underwritten offerings of equity securities.

Mutual fund distributors are not concerned with raising a specific amount of money within a limited time by selling a

(direct sales are rare) who charges a commission for the sale (and purchase) which commission cost is not included in the value of the shares for valuation purposes. The Government's strained analysis asks the Court to believe that fund shares, which have been sold years before and for which the fund and its distributor have continuously maintained a market to redeem (purchase back) such shares at their current net asset value, are similar to a corporate new issue underwriting before a trading market has developed. That such a view bears no reasonable relation to the realities of the situation and cannot be sustained is made clear by the SEC's own Reports, *supra*.

The only real value the estate can realize is the redemption value, not the retail price. As the court of appeals noted, if the retail price of a property is an "unreasonable or unrealistic value standard" then it need not be followed

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stated quantity of securities to the public. They continuously sell as many shares of the funds they serve as they possibly can. Although both mutual fund and conventional underwriters bear business risks, mutual fund underwriters assume neither the reputation risks nor the capital risk inherent in conventional firm commitment underwritings. They sell in a price-protected market, since no dealer, whether or not a member of the selling group, may sell shares to the public at less than the current offering price described in the prospectus. And, since the offering price fluctuates as the net asset value of the fund's shares changes and since the fund redeems outstanding shares at current net asset value, the principal underwriter is never called upon to risk its capital in stabilizing the price of a fluctuating security.

Nor does the principal underwriter of a mutual fund bear the expense of selecting securities for distribution and of negotiating the terms and conditions of each offering as does the conventional underwriter. Unlike the underwriting spread, the mutual fund sales load pays only for the continuous promotional efforts of principal underwriters and for the continuous sales efforts of those who retail fund shares to the public. (Footnotes omitted).

in valuation disputes "as the sole criterion of value." (457 F.2d at 571).

The retail standard is certainly an "unreasonable or unrealistic value standard" in this situation and the Government's insistence on its application is unreasonable and inequitable. It imposes a burden on the redeemability of mutual fund shares which unfairly discriminates against fund shareholders and is contrary to the policy implicit in Section 22(e) and the other provisions of the 1940 Act, as well as the existing valuation standards applied by the Government in analogous situations.

CONCLUSION

For the foregoing reasons the judgment of the court of appeals should be affirmed.

Respectfully submitted,

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APPENDIX

Investment Company Act of 1940, as amended (15 U.S.C. 80a-1, et seq.)

Sec. 2(a). When used in this title, unless the context otherwise requires—

* * *

(32) "Redeemable security" means any security, other than short-term paper, under the terms of which the holder, upon its presentation to the issuer or to a person designated by the issuer, is entitled (whether absolutely or only out of surplus) to receive approximately his proportionate share of the issuer's current net assets, or the cash equivalent thereof.

* * *

(41) "Value," with respect to assets of registered investment companies, except as provided in subsection (b) of section 28 of this title, means—

(A) as used in sections 3, 5, and 12 of this title, (i) with respect to securities owned at the end of the last preceding fiscal quarter for which market quotations are readily available, the market value at the end of such quarter; (ii) with respect to other securities and assets owned at the end of the last preceding fiscal quarter, fair value at the end of such quarter, as determined in good faith by the board of directors; and (iii) with respect to securities and other assets acquired after the end of the last preceding fiscal quarter, the cost thereof; and

(B) as used elsewhere in this title, (i) with respect to securities for which market quotations are readily available, the market value of such securities; and (ii) with

respect to other securities and assets, fair value as determined in good faith by the board of directors;

In each case as of such time or times as determined pursuant to this title, and the rules and regulations issued by the Commission hereunder. Notwithstanding the fact that market quotations for securities issued by controlled companies are available, the board of directors may in good faith determine the value of such securities: *Provided*, That the value so determined is not in excess of the higher of market value or asset value of such securities in the case of majority-owned subsidiaries, and is not in excess of market value in the case of other controlled companies.

For purposes of the valuation of those assets of a registered diversified company which are not subject to the limitations provided for in section 5(b)(1), the Commission may, by rules and regulations or orders, permit any security to be carried at cost, if it shall determine that such procedure is consistent with the general intent and purposes of this title. For purposes of sections 5 and 12, in lieu of values determined as provided in clause (A) above, the Commission shall by rules and regulations permit valuation of securities at cost or other basis in cases where it may be more convenient for such company to make its computations on such basis by reason of the necessity or desirability of complying with the provisions of any United States revenue laws or rules and regulations issued thereunder, or the laws or the rules and regulations issued thereunder of any State in which the securities of such company may be qualified for sale.

* * *

DEFINITION OF INVESTMENT COMPANY

Sec. 3. (a) When used in this title, "investment company" means any issuer which—

(1) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities;

(2) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or

(3) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis.

As used in this section, "investment securities" includes all securities except (A) Government securities, (B) securities issued by employees' securities companies, and (C) securities issued by majority-owned subsidiaries of the owner which are not investment companies.

* * *

SUBCLASSIFICATION OF MANAGEMENT COMPANIES

Sec. 5. (a) For the purposes of this title, management companies are divided into open-end and closed-end companies, defined as follows:

(1) "Open-end company" means a management company which is offering for sale or has outstanding any redeemable security of which it is the issuer.

(2) "Closed-end company" means any management company other than an open-end company.

* * *

DISTRIBUTION, REDEMPTION, AND REPURCHASE OF REDEEMABLE SECURITIES

Sec. 22. (a) A securities association registered under section 15A of the Securities Exchange Act of 1934 may prescribe, by rules adopted and in effect in accordance with said section and subject to all provisions of said section applicable to the rules of such an association—

(1) a method or methods for computing the minimum price at which a member thereof may purchase from any investment company any redeemable security issued by such company and the maximum price at which a member may sell to such company any redeemable security issued by it or which he may receive for such security upon redemption, so that the price in each case will bear such relation to the current net asset value of such security computed as of such time as the rules may prescribe; and

(2) a minimum period of time which must elapse after the sale or issue of such security before any resale to such company by a member or its redemption upon surrender by a member;

(3) in each case for the purpose of eliminating or reducing so far as reasonably practicable any dilution of the value of other outstanding securities of such company or

any other result of such purchase, redemption, or sale which is unfair to holders of such other outstanding securities; and said rules may prohibit the members of the association from purchasing, selling, or surrendering for redemption any such redeemable securities in contravention of said rules.

* * *

(b)(1) Such a securities association may also, by rules adopted and in effect in accordance with said section 15A, and notwithstanding the provisions of subsection (b)(8) thereof but subject to all other provisions of said section applicable to the rules of such an association, prohibit its members from purchasing, in connection with a primary distribution of redeemable securities of which any registered investment company is the issuer, any such security from the issuer or from any principal underwriter except at a price equal to the price at which such security is then offered to the public less a commission, discount, or spread which is computed in conformity with a method or methods, and within such limitations as to the relation thereof to said public offering price, as such rules may prescribe in order that the price at which such security is offered or sold to the public shall not include an excessive sales load but shall allow for reasonable compensation for sales personnel, broker-dealers, and underwriters, and for reasonable sales loads to investors. The Commission shall on application or otherwise, if it appears that smaller companies are subject to relatively higher operating costs, make due allowance therefor by granting any such company or class of companies appropriate qualified exemptions from the provisions of this section.

(2) At any time after the expiration of eighteen months from the date of enactment of the Investment Company

Amendments Act of 1970, or after a securities association has adopted rules as contemplated by this subsection, the Commission may make such rules and regulations pursuant to section 15(b)(10) of the Securities Exchange Act of 1934 as are appropriate to effectuate the purpose of this subsection with respect to sales of shares of a registered investment company by broker-dealers subject to regulation under section 15(b)(8) of that Act: Provided, That the underwriter of such shares may file with the Commission at any time a notice of election to comply with the rules prescribed pursuant to this subsection by a national securities association specified in such notice, and thereafter the sales load shall not exceed that prescribed by such rules of such association, and the rules of the Commission as hereinabove authorized shall thereafter be inapplicable to such sales.

(3) At any time after the expiration of eighteen months from the date of enactment of the Investment Company Amendments Act of 1970, (or, if earlier, after a securities association has adopted for purposes of paragraph (1) any rule respecting excessive sales loads) the Commission may alter or supplement the rules of any securities association as may be necessary to effectuate the purposes of this subsection in the manner provided by section 15A(k)(2) of the Securities Exchange Act of 1934.

(4) If any provision of this subsection is in conflict with any provision of any law of the United States in effect on the date this subsection takes effect, the provisions of this subsection shall prevail.

* * *

(d) No registered investment company shall sell any redeemable security issued by it to any person except either

to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus. Nothing in this subsection shall prevent a sale made (i) pursuant to an offer of exchange permitted by section 11 including any offer made pursuant to section 11(b); (ii) pursuant to an offer made solely to all registered holders of the securities, or of a particular class or series of securities issued by the company proportionate to their holdings or proportionate to any cash distribution made to them by the company (subject to appropriate qualifications designed solely to avoid issuance of fractional securities); or (iii) in accordance with rules and regulations of the Commission made pursuant to subsection (b) of section 12.

(e) No registered investment company shall suspend the right of redemption or postpone the date of payment or satisfaction upon redemption of any redeemable security in accordance with its terms for more than seven days after the tender of such security to the company or its agent designated for that purpose for redemption except—

(1) for any period (A) during which the New York Stock Exchange is closed other than customary week-end and holiday closings or (B) during which trading on the New York Stock Exchange is restricted;

(2) for any period during which an emergency exists as a result of which (A) disposal by the company of securities owned by it is not reasonably practicable or (B) it is not

reasonably practicable for such company fairly to determine the value of its net assets; or

(3) for such other periods as the Commission may by order permit for the protection of security holders of the company.

The Commission shall by rules and regulations determine the conditions under which (i) trading shall be deemed to be restricted and (ii) an emergency shall be deemed to exist within the meaning of this subsection.

GENERAL RULES AND REGULATIONS, Investment Company Act of 1940—

* * *

Rule 2a-4. Definition of "Current Net Asset Value" for Use in Computing Periodically the Current Price of Redeemable Security.

(*a*) The current net asset value of any redeemable security issued by a registered investment company used in computing periodically the current price for the purpose of distribution, redemption, and repurchase means an amount which reflects calculations, whether or not recorded in the books of account, made substantially in accordance with the following, with estimates used where necessary or appropriate:

(1) Portfolio securities with respect to which market quotations are readily available shall be valued at current market value, and other securities and assets shall be valued at fair value as determined in good faith by the board of directors of the registered company.

(2) Changes in holdings of portfolio securities shall be reflected no later than in the first calculation on the first business day following the trade date.

(3) Changes in the number of outstanding shares of the registered company resulting from distributions, redemptions, and repurchases shall be reflected no later than in the first calculation on the first business day following such change.

(4) Expenses, including any investment advisory fees, shall be included to date of calculation.

(5) Dividends receivable shall be included to date of calculation either at ex-dividend dates or record dates, as appropriate.

(6) Interest income and other income shall be included to date of calculation.

(*b*) The items which would otherwise be required to be reflected by subparagraphs (4) and (6) above need not be so reflected if cumulatively, when netted, they do not amount to as much as 1 cent per outstanding share.

(*c*) Notwithstanding the requirements of paragraph (*a*) above, any interim determination of current net asset value between calculations made as of the close of the New York Stock Exchange on the preceding business day and the current business day may be estimated so as to reflect any change in current net asset value since the closing calculation on the preceding business day.

National Association of Securities Dealers, Inc.
RULES OF FAIR PRACTICE

* * *

Art. III, Sec. 26

* * *

CONDITIONS FOR DISCOUNTS TO DEALERS

(c) No member may purchase at a discount from a public offering price any security of an open-end investment company from an underwriter of such securities unless the underwriter is also a member. No member who is an underwriter of the securities of an open-end investment company shall sell any such security to any dealer or broker at any price other than a public offering price unless (1) such dealer or broker is a member and (2) at the time of the sale a sales agreement is in effect between the parties. The sales agreement shall set forth the concession to be received by the dealer or broker and contain the provisions set forth in paragraphs (f), (g), (i) and subparagraphs (1) and (3) of paragraph (j). In addition, the sales agreement may contain among its provisions such of the other requirements of this rule as the parties may deem pertinent or appropriate, but the failure so to include any such other requirement shall not exempt any transaction from the effect of this rule or any part thereof.

GROSS SELLING COMMISSION

(d) No member who is an underwriter shall participate in the offering or in the sale of any such security if the public offering price includes a gross selling commission or load (i.e. the difference between the public offering price and the price received by the issuer) which is unfair, taking into consideration all relevant circumstances, including the

current marketability of such security and all expenses involved.

Calculation of public offering price

(e) No member shall offer or sell any such security except at the effective public offering price described in the current prospectus of the issuing company and in accordance with rules and regulations of the Securities and Exchange Commission, including any interpretations thereunder.

(Slip Opinion)

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Lumber Co.*, 200 U.S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

UNITED STATES *v.* CARTWRIGHT, EXECUTOR

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

No. 71–1665. Argued January 16, 1973—Decided May 7, 1973

Shares in mutual funds can be "sold" by the shareholder only back to the fund and only at a set redemption price. Treas. Reg. § 20.2031–8 (b), requiring that such shares be valued for federal estate tax purposes at the current public offering ("asked") price, which is determined by adding a load or sales charge to the net asset value, is clearly inconsistent with the Investment Company Act of 1940, and is therefore invalid. Pp. 5–12.

457 F. 2d 567, affirmed.

WHITE, J., delivered the opinion of the Court, in which DOUGLAS, BRENNAN, MARSHALL, BLACKMUN, and POWELL, JJ., joined. STEWART, J., filed a dissenting opinion, in which BURGER, C. J., and REHNQUIST, J., joined.

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SUPREME COURT OF THE UNITED STATES

No. 71–1665

United States, Petitioner, *v.* Douglas B. Cartwright, as Executor of the Estate of Ethel B. Bennett.	On Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

[May 7, 1973]

MR. JUSTICE WHITE delivered the opinion of the Court.

The Internal Revenue Code of 1954 requires that, for estate tax purposes, the "value" of all property held by a decedent at the time of death be included in the gross estate. 26 U. S. C. § 2031. By regulation, the Secretary of the Treasury has determined that shares in open-end investment companies or mutual funds are to be valued at their public offering price or "asked" price at the date of death. Treas. Reg. § 20.2031–8 (b) (1963). The question this case presents is whether that determination is reasonable in the context of the market for mutual fund shares.

At the time of her death in 1964, Ethel B. Bennett owned approximately 8,700 shares of three mutual funds that are regulated by the Investment Company Act of 1940, 54 Stat. 789, as amended, 15 U. S. C. § 80a–1, *et seq.*[1] The 1940 Act seeks generally to regulate pub-

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[1] The decedent owned 2,568.422 shares of Investors Mutual, Inc., in her own name, and 2,067.531 shares as trustee for her daughter. The decedent also owned 2,269.376 shares of Investors Stock Fund, Inc., and 1,869.159 shares of Investors Selective Fund, Inc.

For thorough discussions of the operations of open-end investment

licly held companies that are engaged in investing in securities. Open-end investment companies, or mutual funds, "dominate" this industry. 1966 SEC Report, p. 43. Unquestionably, the most unique characteristic of mutual funds is that they are permitted, under the Act, to market their shares continuously to the public, but are required to be prepared to redeem outstanding shares at any time. § 80a-22 (e). The redemption price (or "bid" price) that a shareholder may receive is set by the Act at approximately the fractional value per share of the fund's net assets at the time of redemption. § 80-2 (32). In contrast, the "asked" price, or the price at which the fund initially offers its shares to the public, includes not only the net asset value per share at the time of sale, but also a fixed sales charge or "sales load" assessed by the fund's principal underwriter who acts as an agent in marketing the fund's shares. § 80a-2 (35).[2] Sales loads vary within fixed limits from mutual fund to mutual fund, but all are paid to the funds' underwriters; the charges do not become part of the assets of the fund.[3] The sales loads of the funds held by the

companies, see SEC, Report on Public Policy Implications of Investment Company Growth, H. R. Rep. No. 2337, 89th Cong., 2d Sess. (1966) (hereinafter, 1966 SEC Report); SEC Report of Special Study of Securities Markets, c. XI, Open-End Investment Companies (Mutual Funds), H. R. Doc. No. 95, pt. 4, 88th Cong., 1st Sess. (1963) (hereinafter, 1963 Special Study).

[2] A number of mutual funds are so-called "no-load funds"; in such cases the bid and asked prices are the same. See 1966 SEC Report, pp. 58-59. The underwriter for all three funds involved in this case is Investors Diversified Services, Inc. (IDS), which is not itself an open-end investment company. IDS also serves as the investment manager of the funds, for which it receives separate management fees. See 15 U. S. C. § 80a-15.

[3] The 1963 Special Study (pp. 96-97) explained the trading in mutual fund shares as follows:

"Mutual fund shares are not traded on exchanges or generally in the over-the-counter market, as are other securities, but are

decedent ranged from seven and eight percent to one percent of the fractional net asset value of the funds' shares.

Private trading in mutual fund shares is virtually nonexistent.[4] Thus, at any given time, under the statutory scheme created by the Investment Company Act, shares of any open-end mutual fund with a sales load are being sold at two distinct prices. Initial purchases by the public are made from the fund, at the "asked" price, which includes the load. But shareholders "sell" their shares back to the fund at the statutorily defined redemption or bid price.

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sold by the fund through a principal underwriter, and redeemed by the fund, at prices which are related to 'net asset value.' The net asset value per share is normally computed twice daily by taking the market value at the time of all portfolio securities, adding the value of other assets and subtracting liabilities, and dividing the result by the number of shares outstanding. Shares of most funds are sold for a price equal to their asset value plus a sales charge or commission, commonly referred to as the 'sales load,' and usually ranging from 7.5 to 8.5 percent of the amount paid, or 8.1 to 9.3 percent of the amount invested. A few funds, however, known as 'no-load' funds, offer their shares for sale at net asset value without a sales charge. Shares of most funds are redeemed or repurchased by the funds at their net asset value, although a few funds charge a small redemption fee. The result of this pricing system, it is apparent, is that the entire cost of selling fund shares is generally borne exclusively by the purchaser of new shares and not by the fund itself. In this respect the offering of mutual fund shares differs from, say the offering of new shares by a closed-end investment company or an additional offering 'at the market' of shares of an exchange-listed security, where at least a portion of the selling cost is borne by the company selling the shares." (Footnote omitted.)

[4] See *Estate of Wells* v. *Commissioner*, 50 T. C. 871, 873 (1968), aff'd *sub nom. Ruehlmann* v. *Commissioner*, 418 F. 2d 1302 (CA6 1969), cert. denied, 398 U. S. 950 (1970); 1966 SEC Report, p. 42; and 1963 Special Study, p. 96.

Respondent is the executor of the decedent's estate. On the federal estate tax return, he reported the value of the mutual fund shares held by the decedent at their redemption price, which amounted to about $124,400. The Commissioner assessed a deficiency based upon his valuation of the shares at their public offering or asked price, pursuant to Treas. Reg. § 20.2031-8 (b).[4] Valued on that basis, the shares were worth approximately $133,300. Respondent paid the deficiency of about $3,100, including interest, filed a timely claim for a refund, and, when that claim was denied, commenced a refund action in federal district court on the ground that the valuation based on § 20.2031-8 (b) was unreasonable. The District Court agreed with respondent and held the Regulation invalid. 323 F. Supp. 769. The Court of Appeals affirmed. 457 F. 2d 567. We granted the Government's petition for certiorari, 409 U. S. 840, because of the conflict among the circuits.[5]

[4] The regulation reads, in part, as follows:

"(b) *Valuation of shares in an open-end investment company.* (1) The fair market value of a share in an open-end investment company (commonly known as a 'mutual fund') is the public offering price of a share, adjusted for any reduction in price available to the public in acquiring the number of shares being valued. In the absence of an affirmative showing of the public offering price in effect at the time of death, the last public offering price quoted by the company for the date of death, shall be presumed to be the applicable public offering price. . . .

"(2) The provisions of this paragraph shall apply with respect to estates of decedents dying after October 10, 1963."

This regulation was promulgated in 1963, T. D. 6680, 28 Fed. Reg. 10872, after some years of confusion within the Treasury Department and between that Department and the Department of Justice. See the District Court's opinion, 323 F. Supp. 769, 777. A corresponding regulation was adopted for gift tax purposes. Treas. Reg. § 25.2512-6 (b).

[5] In *Estate of Wells v. Commissioner, supra,* the Tax Court sustained the regulation, with six judges dissenting. That decision

We recognize that this Court is not in the business of administering the tax laws of the Nation. Congress has delegated that task to the Secretary of the Treasury, 26 U. S. C. § 7805 (a), and regulations promulgated under his authority, if found to "implement the congressional mandate in some reasonable manner," must be upheld. *United States* v. *Correll*, 389 U. S. 299, 307 (1967). See *Bingler* v. *Johnson*, 394 U. S. 741, 749–751 (1969); *Commissioner* v. *South Texas Lumber Co.*, 333 U. S. 496, 501 (1948). But that principle is to set the framework for judicial analysis; it does not displace it. We find that the contested regulation is unrealistic and unreasonable and therefore affirm the judgment of the Court of Appeals.

In implementing 26 U. S. C. § 2031, the general principle of the Treasury Regulations is that the value of property is to be determined by its fair market value at the time of the decedent's death. "The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." Treas. Reg. § 20.2031–1 (b). The willing buyer-willing seller test of fair market value is nearly as old as the federal income, estate, and gifts taxes themselves, and is not challenged here.[7] Under this test, it is clear that if the

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was affirmed by the Sixth Circuit in *Ruehlmann* v. *Commissioner*, 418 F. 2d 1302 (1968), cert. denied, 398 U. S. 950 (1970). The companion gift tax regulation was upheld in *Howell* v. *United States*, 414 F. 2d 45 (CA7 1969). Regulation § 20.2031–8 (b) was held invalid in *Davis* v. *United States*, 460 F. 2d 769 (CA9 1972), aff'ing 306 F. Supp. 949 (CD Cal. 1969). See also *Hicks* v. *United States*, 335 F. Supp. 474 (Colo. 1972), appeal pending, No. 72–1360 (CA10).

[7] See Treas. Reg. 63 Relating to Estate Tax Under the Revenue Act of 1921, Art. 13 (1922 ed.) ("The criterion of such value is the price which a willing buyer will pay to a willing seller for the property in question under the circumstances existing at the date of

decedent had owned ordinary corporate stock listed on an exchange its "value" for estate tax purposes would be the price the estate could have obtained if it had sold the stock on the valuation date, that price being, under Treas. Reg. § 20.2031-2 (b), the mean between the highest and lowest quoted selling prices on that day. Respondent urges that similar treatment be given mutual fund shares and that, accordingly, their value be measured by the redemption price at the date of death, the only price that the estate could hope to obtain if the shares had been sold.

Respondent's argument has the clear ring of common sense to it, but the United States maintains that the redemption price does not reflect the price that a willing buyer would pay, inasmuch as the mutual fund is under a statutory obligation to redeem outstanding shares whenever they are offered. According to the Government, the only market for mutual fund shares that has both willing buyers and willing sellers is the public offering market. Therefore, the price in that market, the asked price, is an appropriate basis for valuation. The central difficulty with this argument is that it unrealistically bifurcates the statutory scheme for the trading in mutual fund shares. To be sure, the fund is under an obligation to redeem its shares at the stated price. 15 U. S. C. § 80a-22 (e). But, at the time of the original purchases, both the fund and the purchasers are aware of that duty and both willingly enter into the sale transactions nonetheless. As Judge Winner correctly observed in *Hicks* v. *United States*, *supra*, 335 F. Supp., at 481:

> "Viewing the contract in this light meets every test of the 'willing buyer-willing seller' definition usually applied in the determination of market value. The 'willing buyer' is the fully informed person who

the decedent's death . . . ."); Treas. Reg. 105 Relating to the Estate Tax Under the Internal Revenue Code (of 1939), § 81.10 (1942).

agrees to buy the shares, agreeing at that time to sell them to the fund—the only available repurchaser—at the redemption price. The 'willing seller' is the fund which sells the shares at market value plus a load charge, and which agrees to buy the shares back at market less the load charge. That is the market, and it is the only market. It is a market made up of informed buyers and an informed seller, all dealing at arm's length."

In the context of the Investment Company Act, the redemption price may thus be properly viewed only as the final step in a voluntary transaction between a willing buyer and a willing seller. As a matter of statutory law, holders of mutual fund shares cannot obtain the "asked" price from the fund. That price is never paid by the fund; it is used by the fund when selling its shares to the public—and even then the fund receives merely the net asset value per share from the sale, with the sales load being paid directly to the underwriter. In short, the only price that a shareholder may realize and that the fund—the only buyer—will pay is the redemption price. In the teeth of this fact, Regulation 20.2032-8 (b) purports to assign a value to mutual fund shares that the estate could not hope to obtain and that the fund could not offer.

In support of the Regulation, the Government stresses that many types of property are taxed at values above those which could be realized during an actual sale. For example, ordinary corporate stock is valued at its fair market price without taking into account the brokerage commission that a seller must generally pay in order to sell the stock. Respondent does not contend that that approach is inappropriate or that, for example, the value of ordinary stock in an estate should be the market price at the time less anticipated brokerage fees. But § 20.2031-8 (b) operates in an entirely different fashion.

The regulation includes as an element of value the commission cost incurred in the hypothetical *purchase* of the mutual fund shares already held in the decedent's estate. If that principle were carried over to the ordinary stock situation, then a share traded at $100 on the date of death would be valued not at $100, as it now is, but at, say, $102, representing the "value" plus the fee that a person buying the stock on that day would have to pay. It hardly need be said that such a valuation method is at least inconsistent with long-established Treasury practice and would appear at odds with the basic notions of valuation embodied in the Internal Revenue Code.[8] See *Estate of Wells* v. *Commissioner, supra,* 50 T. C., at 880 (Tannenwald, J., dissenting).

Even if it were assumed that the public offering price were somehow relevant to the value of mutual fund shares privately held, there would still be the difficulty that shares so held are, in important respects, similar to ordinary corporate stock held subject to a restrictive agreement (such as a first refusal right at a specified price). With respect to the value of such stock, the Treasury Regulations have provided that the price that may be obtained in the marketplace does not control. Rather, so long as the restriction is a bona fide one, the value of the shares in the hands of the restricted stockholder is determined in accordance with the terms of the restriction. Treas. Reg. § 20.2031-2 (h). Outstanding mutual fund shares are likewise held subject to a restriction, as the Court of Appeals noted. 457 F. 2d, at 571. Those shares may not be "sold" at the public offering price. By statute, they may be "sold" back to the mutual fund

[8] Whatever the situations may be where it is realistic and appropriate under Treas. Reg. § 20.2031-1 (b) (1965) to use a standardized retail price to measure value for estate tax purposes, it is sufficient to note here that, for the reasons given, the valuation of mutual fund shares does not present one of those situations.

only at the redemption price. We see no valid justification for disregarding this reality connected with the ownership of mutual fund shares.

The Government nevertheless argues that Treas. Reg. § 20.2031-8 (b) reasonably values the "bundle of rights" that are transferred with the ownership of the mutual funds shares.[9] For this argument, heavy reliance is placed on this Court's decisions in *Guggenheim* v. *Rasquin*, 312 U. S. 254 (1941); *Powers* v. *Commissioner*, 312 U. S. 259 (1941); *United States* v. *Ryerson*, 312 U. S. 260 (1941), which held that the cash-surrender value of a single-premium life insurance policy did not necessarily represent its only taxable value for federal gift tax purposes.[10] In *Guggenheim*, the lead case, the taxpayer purchased single-premium life insurance policies with an aggregate face value of one million dollars for approximately $852,000 and, shortly thereafter, gave the policies to her children. On the gift tax return, the policies were listed at their cash-surrender value of about $717,000—admittedly the only amount the donor or the donees could receive, if the policies were surrendered. But the Com-

[9] The Government argues that, as a practical matter, an estate would rarely be hurt by valuation of mutual fund shares at the asked price, because Treas. Reg. § 20.2053-3 (d)(2) permits an estate to deduct the difference between the asked and bid prices if the shares are sold to pay certain enumerated expenses. By its terms, however, that regulation applies only if "the sale is *necessary*" to pay those expenses. (Emphasis added.) In any event, the regulation is inapplicable altogether if the shares are transferred in kind to an heir or legatee.

[10] It is no coincidence that the contested regulation was placed in Treas. Reg. § 20.2031-8, which deals with "Valuation of certain life insurance and annuity contracts . . . ." But we agree with Judge Winner:

"The Commissioner cannot cross-breed life insurance and investment trust shares by the single expedient of discussing them in separate paragraphs of a single regulation." *Hicks* v. *United States*, *supra*, 335 F. Supp., at 482.

missioner valued the gift at the cost of the policies, and this Court upheld that valuation: "the owner of a fully paid life insurance policy has more than the mere right to surrender it; he has the right to retain it for its investment virtues and to receive the face amount of the policy upon the insured's death. That these latter rights are deemed by purchasers of insurance to have substantial value is clear from the difference between the cost of a single-premium policy and its immediate or early cash-surrender value . . . ." 312 U. S., at 257. Because the "entire bundle of rights in a single-premium policy" is so difficult to give a realistic value to, the Court deferred to the Commissioner's determination and permitted valuation to be based on cost: "Cost is cogent evidence of value." 312 U. S., at 258. But as the District Court observed, 323 F. Supp., at 773, shares in mutual funds are quite unlike insurance policies, particularly in light of the policyowner's right to receive the full face value of the policy upon the insured's death. Moreover, mutual fund shares present no analogous difficulties in valuation. On any given day, their commercial value may be determined by turning to the financial pages of a newspaper. Obviously, with respect to mutual funds, there are "investment virtues" and the prospects of capital gains or dividends. But that is true of any corporate security. Nonetheless, shareholders in mutual funds are singled out by the Regulation and their holdings valued at an unrealistic replacement cost—which includes "brokers' commissions"—while other shareholdings are valued without regard to such commissions.

The unrealistic nature of this difference in treatment may be demonstrated by comparing the treatment of shares in load funds, such as the decedent's, with shares in no-load funds. Obviously, even if it could be argued that there are relevant differences between mutual fund shares generally and corporate stock, there are no dif-

ferences in terms of "investment virtues" or related interests between no-load and load fund shares. Indeed, as the terms imply, the only real distinction between the two is that one imposes an initial sales charge and the other does not.[11] Nonetheless, under the Regulation, a share in a no-load fund is valued at its net asset value while a share in a load fund is valued at net asset value plus sales charge. To further illustrate, consider a decedent who had purchased one share in each of two no-load mutual funds, at $100 per share. The decedent died before either appreciated, but after one of the funds had changed to a load fund. Although both shares are still worth $100, and could be redeemed for only that amount, the Regulation would require that one be valued at $100 and the other at $100 plus the new load charge. A regulation that results in such differing treatment of identical property should be supported by something more than a transparent analogy to life insurance.

We recognize that normally "Treasury regulations must be sustained unless unreasonable and plainly inconsistent with the revenue statutes." *Commissioner* v. *South Texas Lumber Co.*, 333 U. S. 496, 501 (1948). But even if the Regulation contested here is not, on its face, technically inconsistent with § 2031 of the Internal Revenue Code, it is manifestly inconsistent with the most elementary provisions of the Investment Company Act of 1940 and operates without regard for the market in mutual fund shares that the Act created and regulates. Cf. *L. E. Shunk Latex Products, Inc.* v. *Commissioner*, 18 T. C. 940 (1952). Congress surely could not have intended § 2031 to be interpreted in such a manner. The Regulation also imposes an unreasonable and unrealistic measure of value. We agree with Judge Tannenwald, who stated at the very outset of the dispute over Regula-

[11] See 1966 SEC Report, pp. 51–59.

tion § 20.2031–8 (b), that "it does not follow that, because [the Commissioner] has a choice of alternatives, his choice should be sustained where the alternative chosen is unrealistic. In such a situation the regulations embodying that choice should be held to be unreasonable." *Estate of Wells v. Commissioner*, *supra*, 50 T. C., at 878 (dissenting opinion).

The judgment of the Court of Appeals is affirmed.

It is so ordered.

SUPREME COURT OF THE UNITED STATES

No. 71-1665

United States, Petitioner, *v.* Douglas B. Cartwright, as Executor of the Estate of Ethel B. Bennett.	On Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

[May 7, 1973]

MR. JUSTICE STEWART, with whom THE CHIEF JUSTICE and MR. JUSTICE REHNQUIST join, dissenting.

This case presents a narrow issue of law regarding the valuation of certain assets—shares in an open-end investment company or "mutual fund"—for purposes of the Federal Estate Tax. The case turns upon a single question of law: whether or not § 20.2031-8 (b) of the Treasury Regulations, which provides a specific method for valuing such shares, represents a reasonable implementation of the legislation enacted by Congress.

On December 4, 1964, Mrs. Ethel Bennett died testate leaving, among other property, several thousand shares in three separate mutual funds. Each of the funds in question is managed by a firm known as Investors Diversified Services, Inc., and all are subject to regulation by the Securities and Exchange Commission under the Investment Company Act of 1940. In his tax return for the estate, the respondent, Mrs. Bennett's executor, valued these shares at their so-called "net asset value," that is, the amount at which the estate is entitled, as a matter of law, to have the shares redeemed by the issuer. The net asset value of a mutual fund share is calculated daily by the issuing company, and is equivalent to the fractional value per share of the fund's total net assets on that day. In addition to serving as a gauge for the redemption value of fund shares already issued, net

asset value is also employed by the issuing companies in determining the price at which they will offer new shares in the fund to the public on any given day. In general, such shares are sold to the public at their net asset value plus a sales charge or "load." The load is a varying percentage of the value of the shares sold, and fluctuates in accordance with the size of the purchase. In the case of Mrs. Bennett's shares, the maximum allowable sales load at the time of her death ranged between 7 and 8%, and the minimum was 1%.

Upon receipt of respondent's return, the Commissioner, acting in accordance with Treasury Regulation § 20.2031-8 (b),* assessed a deficiency, contending that the value of Mrs. Bennett's shares for Federal Estate Tax purposes was their public offering price on the date of her death, that is, the price which a member of the public would have had to pay to acquire similar shares from the issuer. This price would, of course, encompass not only the net asset value of the shares, but also the applicable sales load. Such a method of valuation for mutual fund shares is expressly prescribed by the Treasury Regulation noted above. Thus, the sole question before us is whether that regulation constitutes a reasonable exercise by the Commissioner of his statutory power to prescribe "all needful rules" for the proper enforcement of the tax laws, see 26 U. S. C. § 7805, or whether the regulation is so inherently unreasonable and inconsistent with the statute as to be invalid. *United States* v. *Correll*, 389 U. S. 299; *Bingler* v. *Johnson*, 394 U. S. 741. Upon the facts pre-

*The text of the regulation, insofar as relevant here, reads as follows: "The fair market value of a share in an open-end investment company [commonly known as a "mutual fund"] is the public offering price of a share, adjusted for any reduction in price available to the public in acquiring the number of shares being valued. . . ." There is a companion Gift Tax Regulation of identical import. See 26 CFR § 25.2512-6 (b).

sented by this case, I cannot say that the Commissioner's regulation is invalid, and I therefore dissent from the decision of the Court.

At the outset, it may be well to note the basic general rule with respect to valuation that prevails under our Estate Tax laws. This rule is embodied in Treasury Regulation § 20.2031-1 (b), and provides that the value of property includible in a decedent's estate shall be the fair market value of such property at the date of the decedent's death. "The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." 26 CFR § 20-2031-1 (b).

The difficulty in applying this rule to mutual fund shares—a difficulty which, no doubt, led the Commissioner to promulgate Regulation 20.2031-8 (b)—is that such shares *once issued* are not subject to disposition in a market of "willing buyers" and "willing sellers." Indeed, as both the District Court and the Court of Appeals noted, the only practical means of disposing of mutual fund shares once acquired is redemption, and redemption cannot be deemed a sale of the sort described in the general rule (26 CFR § 20.2031-1 (b)), since the party purchasing (the issuing company) is under an absolute obligation to redeem the shares when tendered, and the party selling has no practical alternative, if he wishes to liquidate his holdings, other than to offer them to the issuing company for redemption.

This being the case, the Commissioner was faced with the problem of establishing a method of valuing the shares most nearly equal to their inherent worth. In doing so, he chose not to treat their redemption value as dispositive of this question. In promulgating his regulation, he might rationally have considered that "on demand" redemption at net asset value is but one of many rights incident to the ownership of mutual fund shares.

For example, in the case of Mrs. Bennett's shares, her estate had not only the right to redeem them "on demand," but also to retain them; and if it had done so it would have possessed not only the normal dividend and capital gains rights associated with most investments, but also the right to have such dividends and capital gains as accrued applied toward the purchase of additional shares at a price *below* that which a member of the general public would have had to pay for such shares. In addition, under the investment contracts involved here, Mrs. Bennett's estate would have had the right to exchange her shares in any one of the three mutual funds involved for those of either or both of the other funds managed by Investors Diversified Services, Inc.—without paying the usual sales charge or load.

The Commissioner has determined that the proper method of valuing all the rights, both redemptive and otherwise, incident to the ownership of mutual fund shares is to determine what a member of the general public, acting under no constraints, would have had to pay for those rights if purchased on the open market. And, as noted earlier, although no such market exists for mutual fund shares *once issued* to an investor, a perfectly normal market of willing buyers and sellers does exist with respect to such shares prior to their issuance. Thus, the Commissioner took the price at which the shares would have sold on this market as fairly reflective of their inherent worth. I cannot say that this method of valuation adopted by the Commissioner, and embodied in Regulation 20.2031-8 (b), is so unreasonable and inconsistent with the statute as to render it invalid.

The respondent's claim that the regulation is invalid is grounded upon two principal arguments. First, he says, the estate is being taxed on an amount in excess of what it can, as a practical matter, realize from the disposition of the mutual fund shares. But this is equally true

of many other assets subject to taxation under our Estate Tax laws. For example, real property passing into an estate is taxed upon its full fair market value, despite the fact that as a practical matter the estate must usually pay some percentage of that sum in brokerage fees if it wishes to dispose of the property and receive cash in its stead. This attack upon the regulation thus amounts to no less than an attack upon the whole system of valuation embodied in the Treasury Regulations on Estate Tax, based as it is upon fair value in an open market. I am not ready to hold that this long established and long accepted system is basically invalid.

The respondent's second argument is that the regulation places a higher valuation on mutual fund shares than is placed upon registered common stock shares and other similarly traded securities. This argument assumes that the redemption or net asset value of a mutual fund share is identical to the fair market value of a traded security, and, by a parity of reasoning, that the sales charge or load associated with mutual fund purchases is equivalent to the commission that a stockbroker charges a purchaser of securities. Under this view, the Commissioner would be entitled to tax mutual fund shares passing into an estate only on their net asset value, since in the allegedly comparable situation of common stock shares no consideration may be given to brokers' commissions in arriving at an appropriate valuation for Estate Tax purposes. See 26 CFR § 20.2031–7 (b).

Although this argument has a certain superficial appeal, the analogy on which it relies is hardly an exact one. For an estate in disposing of marketable securities must pay a brokerage commission on their *sale*, and will thus realize less than the amount at which the securities have been valued, while an estate turning in mutual fund shares for redemption pays no commission or other surcharge whatever. Moreover, unlike traditional securities,

there is no open trading market for mutual fund shares once issued and in the hands of an investor. If such a market of willing buyers and sellers did exist, the Commissioner would doubtless be bound to treat mutual fund shares exactly like other securities. But where no market for an asset exists, there simply is no market price to provide a readily identifiable standard for valuation. Under these circumstances, it is the Commissioner's duty under the statute to establish criteria for determining the true worth of the totality of rights and benefits incident to ownership of the asset. This the Commission has done in Regulation 20.2031–8 (b) by providing that the value of a mutual fund share for Federal Estate Tax purposes shall be the price a member of the general public would have to pay to acquire such share. Such an approach to the valuation of assets not regularly traded in a market of willing buyers and sellers has already been sustained by this Court in a case closely akin to the case before us. See *Guggenheim* v. *Rasquin*, 312 U. S. 254 (1941).

Given the peculiar characteristics of mutual fund shares, it is arguable that the Commissioner might reasonably have adopted a method of valuation different from that which he has chosen. But that is a question that is not for us to decide. "[We] do not sit as a committee of revision to perfect the administration of the tax laws. Congress has delegated to the Commissioner, not the courts, the task of prescribing 'all needful rules and regulations for the enforcement' of the Internal Revenue Code. 26 U. S. C. § 7805 (a). In this area of limitless factual variation, 'it is the province of Congress and the Commissioner not the courts, to make the appropriate adjustments.'" *United States* v. *Correll*, 389 U. S. 299, at 306. See *Bingler* v. *Johnson*, 394 U. S. 741, at 750.

I would reverse the judgment of the Court of Appeals and sustain the validity of the regulation.